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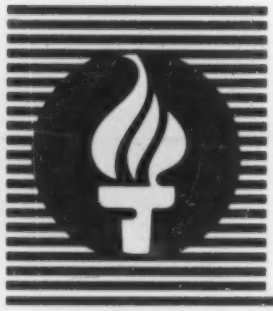

The Conference Board

1992: Leading Issues for European Companies

140 Major European Firms Examine:

- *Increasing cross-border mergers*
- *The liberalization of capital markets and local regulatory control*
- *Growing concern over tax approximation*
- *Expectations and uncertainties in non-EC countries*
- *Burgeoning fears of protectionism*

Research Report No. 921

ABOUT THE CONFERENCE BOARD

The Conference Board is a business information service whose purpose is to assist senior executives and other leaders in arriving at sound decisions. Since its founding in 1916, the Board has been creating close personal networks of leaders who exchange experience and judgment on significant issues in management practice, economics and public policy. The networks are supported by an international program of research and meetings which The Conference Board staff of more than 350 persons carries out from offices in New York, Washington, Ottawa and Brussels.

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The Conference Board, Inc.
845 Third Avenue
New York, New York 10022
(212) 759-0900
RCA International Telex
237282 and 234465

The Conference Board, Inc.
Avenue Louise, 207 - Bte 5
B-1050 Brussels, Belgium
(02) 640 62 40
Telex: 63635

The Conference Board, Inc.
1755 Massachusetts Avenue, N.W.
Suite 312
Washington, D.C. 20036
(202) 483-0580

The Conference Board of Canada
255 Smyth Road
Ottawa, Ontario K1H 8M7
(613) 526-3280

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1992: Leading Issues for European Companies

by Catherine Morrison

A Report from The Conference Board

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From the President

The accelerating pace of change in the world economy is moving Europe forward in its quest for market integration. The task is formidable, complicated not only by differences within Europe, but also by the recognition that Europe must contend with continuing changes in the wider international arena. Both the United States and Japan look optimistically to the opportunities provided by an integrated market, and apprehensively to the possibility of protectionist barriers against their products and services.

This report summarizes the findings of a Conference Board survey in Europe on public policy issues management, and serves as a baseline against which to measure shifting attitudes and priorities. It should provide a useful guide for corporate officers gearing up to meet the economic challenges of more integrated markets in 1992.

The Conference Board is grateful to its European Public Affairs Council for their help in designing this project, to the 140 companies that participated in the survey, and to those executives, European Economic Community officers, and elected officials who shared their views with the Board.

PRESTON TOWNLEY
President

Highlights

The major issues facing European corporations today, as identifed by surveyed executives, are those related to the creation of a unified market in 1992 and its effect on economic competitiveness. As corporations gear up for the removal of barriers to the flow of goods, labor, and capital, their concerns center on the following:

- International Trade: The problems that remain unaddressed by GATT, combined with the expectations and uncertainties surrounding 1992, have given rise to protectionist fears in some quarters. Trade specialists fear the eventual formation of a Western European trading bloc of 320 million consumers in opposition to a North American (U.S. and Canada) trading bloc of 260 million consumers in opposition to an as-yet-formed Pacific bloc.

- The recent EC decision to liberalize capital markets will eventually lift all remaining controls on short-term financial transactions and direct and equity investments. Local regulatory control will have to be preserved, renewing the debate on the effectiveness and desirability of a common European monetary system and on the establishment of a European central bank. The liberalization is expected to lead to fierce competition among banks for new customers.

- Technology and Economic Competitiveness, a phrase encompassing issues related to productivity, quality, cooperative ventures, and research and development (R&D). The availability of research support, heavily dependent on strong government involvement and therefore a key element in directing industrial priorities, concerns respondents.

The inability of companies to bring new products to market is considered, by European executives, to be one of Europe's greatest managerial weaknesses. Effective commercialization of new technologies has become a priority.

- Merger activities of one kind or another, friendly or unfriendly, will continue to increase. The business community sees mergers, joint ventures, and alliances as the best way to scale up to meet competition from abroad, and they are moving quickly to create such combinations. Cross-border mergers will multiply and be characterized by "agreed bid" rather than takeover tactics. Hostile takeover attempts have not succeeded in pushing Europe's financial and regulatory machinery into high gear. Pending regulatory proposals would require investors to disclose stock ownership information early on. Companies are eager to avoid being hobbled by these proposals.

- Tax approximation is expected to be the biggest single problem area in the move toward economic integration. Value-added taxes (VAT) and excise taxes, if not harmonized, could artificially distort trade.

- Companies are involved in a wide range of environmental issues. One-third of the respondents describe toxic waste disposal as the most pressing concern facing their companies today. Companies look to cross-border emergency planning procedures—plus their own practices—to avert major environmental disasters. In the light of recent nuclear accidents, nuclear power is being re-evaluated as an energy source.

- Unemployment remains a serious, pan-European problem, with estimates ranging between 16 to 20 million unemployed. Ironically, employers report an unmet need for well-trained technical personnel at the entry level. High-tech manufacturers and electronics companies foresee shortages ahead in the availability of people with science, mathematics, and basic computer skills.

Method

To examine the range and variety of public policy issues facing European companies, The Conference Board surveyed officers of European companies during the spring of 1987, and conducted supplemental polling and field interviews during the spring and summer of 1988. The survey and interviews were designed to assess how corporate managers define, rank, and manage various public policy issues.

Survey questionnaires were mailed to 2,200 companies, including 400 Conference Board Associates, and a total of 140 usable responses were obtained.

Slightly less than half the responding firms were from the manufacturing sector, 29 percent were from financial institutions, and 6 percent from the non-financial services sector. The remainder were companies whose principal business was either mining, construction, communications, agriculture, trade, or transporation.

Data from this survey constitutes one of the principal sources of company-related informaton for this report. European Community (EC) documents provided secondary source materials.

The study questionnaire was directed to public affairs officers, a title with job duties not as predictably assigned in European companies as they are in the United States. The assignment of this responsibility to a particular department is much more flexible in Europe, hence the array of job titles held by survey respondents. Titles ranged from chief executive officer, chairman or president, to government relations manager, vice president for corporate planning, head of public affairs and corporate intelligence, company secretary, vice president for international affairs and financial manager. Information relating to the functional organization of public affairs activities within the surveyed corporations may be found in Chapter 6.

In order to gain additional perspective on the increasingly complex issues raised by the survey respondents, personal and telephone interviews were conducted with public affairs officers and functional executives in other relevant departments of the responding companies.

Chapter 1
Gearing Up for 1992

In large measure, the key issues of concern to European corporate officers center around expectations for a unified European market in 1992 and the major consequences this will have for European companies. Few now question the likelihood of the completion of the Internal Market; when that plan will be fully operational is open to discussion, however.

The goal of the EC is nothing less than the full economic integration of Europe. While the 12 member countries of the EC abolished tariffs on each others' exports in the early 1960s, many barriers to trade, as well as to the free flow of labor and capital, remain. The intent of the EC's Internal Market program is to dismantle these barriers, creating a $4 billion market of over 320 million consumers. (This compares with 240 million consumers in the United States and 122 million in Japan.)

The program entails the adoption of close to 300 directives aimed at removing physical barriers (e.g., customs procedures at border crossings), technical barriers (e.g., differing technical standards, restrictions on trade and on services), fiscal barriers (e.g., varying tax codes), elimination of barriers created by varying regulatory and legal systems, and easing of closed public procurement policies. (See box on page 2.) Conservative estimates call for a 5 percent increase in EC GDP and the creation of 2 million new jobs. (See box on page 3.) The combined countries will be a formidable commercial arena, and nearly every major company will rush to adjust to this new market.(See Table 1.)

For various reasons, the integration of the market has been given greater political emphasis in recent years. It is a concept particularly attractive at this time of budgetary crises within the Community; the Internal Market doesn't cost anything. More importantly, the EC ministers collectively have come to see that breaking down barriers is more productive than putting them up.

One of the primary blueprints moving this concept forward is the White Paper drafted by Lord Cockfield in 1985.[1] This document, which plots the course by which the Community navigates towards 1992, analyses the physical, technical, and fiscal barriers that impede the movement of goods, services, people, and capital within the Community. It sets out a comprehensive program for removing these barriers by 1992.

The program was endorsed by the Heads of Government at the Milan Summit in June 1985 and reinforced by the Single European Act, which became effective in July 1987. This Act incorporated a deadline into the Treaty itself, thus improving significantly the Community's decision-making capability. It does so by codifying majority voting and rendering it impossible for one country—or small group of countries—to block a particular proposal indefinitely.

Substantial progress has been made. The acts (or directives) are presented as "proposals on action items" by the Commission to the Council of Ministers and the European Parliament, who then adopt, reject, or table the proposals. All the proposed legislation is expected to be presented by 1989, leaving at least two years for Member States to enact and implement national legislation.

Table 1: Economic Overview of the European Community, 1987

	GNP	Population	Per Capita GNP
	$US Billions	Millions	$US
EC	$4,120.2	323.62	$12,732
Belgium-Luxembourg	144.7	10.27	14,090
Denmark	97.5	5.12	19,041
France	846.9	55.61	15,229
Germany	1,129.9	60.99	18,526
Greece	45.9	10.01	4,584
Ireland	25.6	3.56	7,180
Italy	632.1	57.36	11,021
Netherlands	213.5	14.64	14,581
Portugal	33.4	10.35	3,229
Spain	284.0	38.84	7,312
U.K.	666.7	56.87	11,723
U.S.	4,486.2	243.77	18,403

1. Imports from non-EC countries
2. Total U.S. Imports

Source: "Business in America," U.S. Department of Commerce, August 1, 1988.

[1] "Completing the Internal Market": White Paper from the Commission to the European Council (Milan, 28-29, June 1985), Lord Cockfield, the Commission of the European Communities, Brussels, June, 1985.

The period between February through June 1988 was unusually productive. Under the West German presidency (the presidency rotates every six months), the EC agreed to increase spending, especially among the poorer members, and to reduce agricultural subsidies.

Accords were also reached on reducing barriers to cross-border investments, easing restrictions on bidding for foreign government contracts, and reducing cross-border restrictions on insurance, trucking, and air and sea transport.

But in areas such as financial services, where formidable differences remain between countries, the pace may be slower. A major step was taken in June when Community finance

1992 at a Glance

By 1992, the European Community intends to have implemented 285 regulations to create a single internal market. The following specific changes represent the major part of the 1992 program.

In standards, testing, certification

Harmonization of standards for
- Simple pressure vessels
- Toys
- Automobiles, trucks, and motorcycles and their emissions
- Telecommunications
- Construction products
- Personal protection equipment
- Machine safety
- Measuring instruments
- Medical devices
- Gas appliances
- Agricultural & forestry tractors
- Cosmetics
- Quick frozen foods
- Flavorings
- Food emulsifiers
- Extraction solvents
- Food preservatives
- Infant formula
- Jams
- Modified starches
- Fruit juices
- Food inspection
- Definition of spirited beverages & aromatised wines
- Coffee extracts & chicory extracts
- Food additives
- Materials & articles in contact with food
- Tower cranes (noise)
- Household appliances (noise)
- Tire pressure gauges
- Hydraulic diggers (noise)
- Detergents
- Liquid fertilizers & secondary fertilizers
- Lawn mowers (noise)
- Medicinal products & medical specialities
- Radio interferences
- Earthmoving equipment
- Lifting and loading equipment

New rules for harmonizing packing, labelling and processing requirements
- Ingredients for food & beverages
- Irradiation
- Extraction solvents
- Nutritional labelling
- Classification, packaging, labelling of dangerous preparations
- Food labelling

Harmonization of regulations for the health industry (including marketing)
- Medical specialities
- Pharmaceuticals
- Veterinary medicinal products
- High technology medicines
- Implantable electromedical devices
- Single use devices (disposable)
- In vitro diagnostics

Changes in government procurement regulations
- Coordination of procedures on the award of public works & supply contracts
- Extension of EC law to telecommunications, utilities, transport
- Services

Harmonization of regulation of services
- Banking
- Mutual Funds
- Broadcasting
- Tourism
- Road passenger transport
- Railways
- Information services
- Life & nonlife insurance
- Securities
- Maritime transport
- Air transport
- Electronic payment cards

Liberalization of capital movements
- Long-term capital, stocks
- Short-term

Consumer protection regulations
- Misleading definitions of products
- Indication of prices

Harmonization of laws regulating company behavior
- Mergers & acquisitions
- Trademarks
- Copyrights
- Cross border mergers
- Accounting operations across borders
- Transaction taxes
- Company law

Harmonization of taxation
- Value Added Taxes
- Excise taxes on alcohol, tobacco, and other

Harmonization of veterinary & phytosanitary Controls

Harmonization of an extensive list of rules covering items such as:
- Antibiotic residues
- Bovine animals and meat
- Porcine animals and meat
- Plant health
- Fish & fish products
- Live poultry, poultry meat and hatching eggs
- Pesticide residues in fruit & vegetables

Elimination and simplification of national transit documents and procedures for intra-EC trade
- Introduction of the Single Administrative Document (SAD)
- Abolition of customs presentation charges
- Elimination of customs formalities & the introduction of common border posts

Harmonization of rules pertaining to the free movement of labor and the professions within the EC
- Mutual recognition of higher educational diplomas
- Comparability of vocational training qualifications
- Specific training in general medical practice
- Training of engineers
- Activities in the field of pharmacy
- Activities related to commercial agents
- Income taxation provisions
- Elimination of burdensome requirements related to residence permits

Source: Business America, August 1, 1988

ministers urged removal of all capital controls in eight of the 12 member nations by mid-1990, and in the other four countries by 1992. This liberalization is expected to increase speculative money flows as EC nationals would be able to open bank accounts anywhere in the Community. More importantly, EC banks will be permitted to lend anywhere in the Community.

Microeconomic Estimates of Potential Economic Gains for the EC Resulting from Completion of the Internal Market

The information below was drawn from the recent "Research on the Cost of Non-Europe" by Paolo Cecchini and others. The study evaluated the potential economic benefits resulting from the realization of successfully integrated European markets. It includes not only a detailed economic overall report, but documentary material of more than 6,000 pages, including the result of a manufacturing business survey based on 11,000 answers out of 20,000 firms polled.

	Billions ECU*	% of GDP
1. Gains from removal of barriers affecting trade	8-9	0.2-0.3
2. Gains from removal of barriers affecting overall production	57-71	2.0-2.4
3. Gains from removing barriers (SUBTOTAL)	65-80	2.2-2.7
4. Gains from exploiting economies of scale more fully	61	2.1
5. Gains from intensified competition reducing business ineffectiveness and monopoly profits	46	1.6
6. Gains from market integration (SUBTOTAL)	62**-107	2.1**-3.7
7. TOTAL GAINS		
-for 7 member states at 1985 prices	127-187	4¼-6½
-for 12 member states at 1988 prices	170-250	4¼-6½

All figures except in the last line are expressed at 1985 prices and relate to 7 member states (Germany, France, Italy, United Kingdom, Belgium, the Netherlands and Luxembourg). The aggregate result is scaled up in terms of the 12 member states' 1988 GDP in the last line.

The ranges for certain lines represent the results of using alternative sources of information and methodologies. The 7 member states account for 88% of the GDP of the E.C. Extrapolation of the results in terms of the same share of GDP for the 7 and 12 member states is not likely to over-estimate the total for the 12. The detailed figures in the table relate only to the 7 member states because the underlying studies mainly covered these countries.

* 1 European Currency Unit (ECU) = $1.25 on March 31, 1988.

** This alternative estimate for the sum of line 6 cannot be broken down between the two lines 4 and 5.

Source: "Research on the Cost of Non-Europe" by Paolo Cecchini and others. E.C. Commission

Some movement is seen in the removal of technical barriers. Successes include agreement in dismantling barriers in information technology, pharmaceuticals and mobile telephones. Data transmissions and electronic mail are expected to grow ten-fold in Europe, to $2 billion a year by 1992. The need will grow for networks that can provide credit card verification and link banking services, markets heretofore neglected by the national telephone monopolies.

The EC will attempt to harmonize differing national product standards so that goods will be able to circulate freely. Most of these standards will be basic, such as minimum safety standards for products. Beyond this, EC countries will be obliged to recognize each others' standards, rules and regulations as equivalent to their own and allow companies to trade as freely throughout the Community as they do at home.

Different versions of the same product are still necessary to satisfy national standards and regulations. The possibility of ironing-out differences in technical standards elicits a skeptical response from some sectors. A telecommunications executive comments:

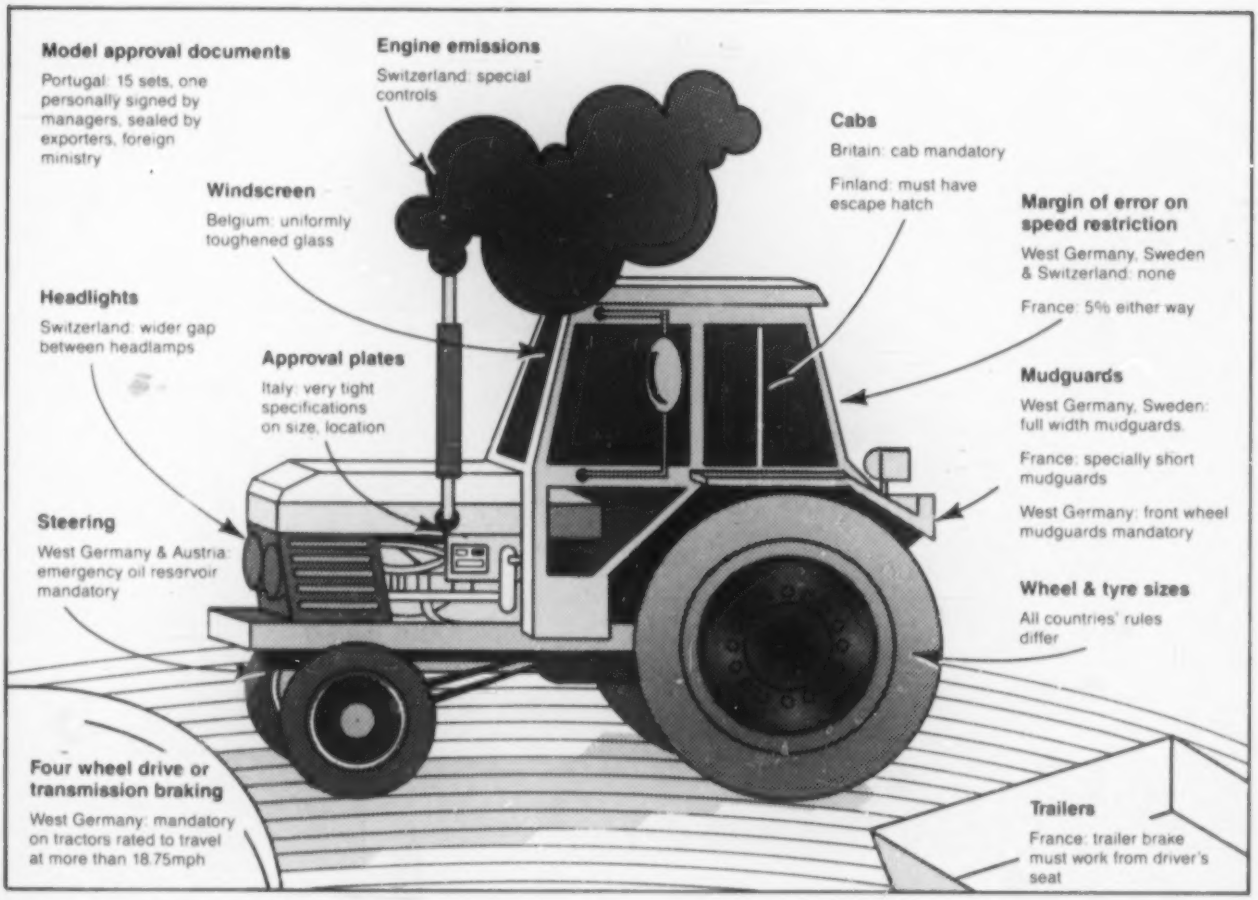
> "Our industry, of course, is a relatively young industry and the advantage we have had is that international standards are used by manufacturers because if you do not have a common standard you cannot connect. Other industries, for example, the automobile industry, move very, very slowly in developing certain standards.
>
> "You look at the French car and the factory has yellow lamps and if it's a German car it has white lamps. Here you have a very simple standard that is incompatible and that's what 1992 is for. If we cannot agree on the color, at least we can recognize each other's standards and allow the French to sell cars with yellow lights to the Germans and allow the Germans to sell cars with white lights to the French."

The ubiquitous farm tractor, whose basic design has not changed in 40 years, is subject to a litany of individual national requirements. As seen in the accompanying drawing from the *Financial Times* while engine, transmission and chassis standards are virtually uniform across Europe, not much else is. (See Figure 1 on page 4.)

Thus, while 200,000 tractors are sold every year in Europe, it is difficult for some producers to manufacture a tractor that will sell in more than a few countries without significant engineering alterations.

By the end of 1992 European countries will no longer be able to exclude, for purely protectionist reasons, products, workers and services from neighboring countries willing to meet the new standards. The unification of the Internal Market should fulfill the intent of the Treaty of Rome. The early hope that this would be accomplished by the creation of a common customs tariff and new approaches to indirect taxation was dashed by a combination of the recession and lack of confidence and vision. The assumption that nontariff barriers were of little importance disappeared during the reces-

Figure 1: Different tractor regulations in EC and EFTA countries


Model approval documents
Portugal: 15 sets, one personally signed by managers, sealed by exporters, foreign ministry
Engine emissions
Switzerland: special controls
Windscreen
Belgium: uniformly toughened glass
Cabs
Britain: cab mandatory
Finland: must have escape hatch
Margin of error on speed restriction
West Germany, Sweden & Switzerland: none
France: 5% either way
Headlights
Switzerland: wider gap between headlamps
Approval plates
Italy: very tight specifications on size, location
Mudguards
West Germany, Sweden: full width mudguards
France: specially short mudguards
West Germany: front wheel mudguards mandatory
Steering
West Germany & Austria: emergency oil reservoir mandatory
Wheel & tyre sizes
All countries' rules differ
Four wheel drive or transmission braking
West Germany: mandatory on tractors rated to travel at more than 18.75mph
Trailers
France: trailer brake must work from driver's seat

SOURCE: *THE FINANCIAL TIMES*, JUNE 1988

sion as these barriers multiplied through the efforts of Member States to protect their short-term interests. To further protect these interests, public funds were increasingly used to protect national markets and industries and to aid non-viable companies.

If expectations for 1992 are to be fulfilled, major changes must, therefore, occur in the public procurement process, due to be opened up after 1992. Government contracts within the Community are estimated to be worth 400 billion ECUs (European Currency Units) or about $500 billion. Only 29 percent of those contracts currently go to firms from other Member States.

The 1992 reforms will also result in a fall in transport costs. Countless hours are lost and profits eaten up by the delays at border crossings. Philips, for example, says their trucks spend an average of 30 percent of their travel time stopped at customs posts.

Wider worker mobility is expected. Proposals to grant holders of professional qualifications the right to work anywhere in the Community have won support. This would allow all officially regulated professionals—doctors, lawyers, dentists, architects, accountants, etc.—to work in any Member State subject only to basic tests or training periods.

The creation of a vast single market is expected to change the climate for research and development (R&D) activities. Harmonizing standards and joint efforts should free up more money for research. For example, Europe's ten different telephone switching systems cost $10 billion to develop, compared with three U.S. companies jointly spending $3 billion to develop a common system and, even more efficiently, Japan's expenditure of $1.5 billion on a single system.

The lure of the expanded market is likely to increase merger activities, as companies experience the need to grow in order to operate on the larger scale. While no one can predict success or failure, it is clear that stronger, more aggressive companies will emerge and then move into world markets. At the same time, multinational companies, be they European, U.S. or Japanese, should find it simpler and cheaper to manufacture and sell in Europe, assuming that protectionist measures are not levied against them.

Chapter 2
The Five Most Important Issues

For the purposes of this report, a list of issues that companies could choose from was provided in the survey. As mentioned earlier, the issue topics came from a polling of The Conference Board's European Public Affairs Council members. In total, 24 major issue categories were identified. (See box on page 6.) Respondents were also asked to indicate additional issues of concern to their companies. The issues listed in Table 4 (page 32) reflect these additions.

The following five areas—those of greatest concern—were determined by a weighted ranking:

1. *International trade* (includes obstacles to trade, comprising tariffs, non-tariff barriers, etc., and completing the Internal Market).

International trade issues are the overwhelming concern of most companies polled. The problems that remain unaddressed by the current GATT round, combined with uncertainties surrounding the 1992 EC integration goals, have given rise to protectionist fears in some quarters. (See page 7.) "We fear the lack of an external policy for 1992," reports a French electronics manufacturer. "We know the EC needs its own unique identity, but we don't know whether the Community will become a vast open market for non-European countries or will turn inward on itself."

2. *Technology and economic competitiveness* (includes research support, tax credits, copyrights and patents, intellectual property rights, science and engineering education, cross-frontier data flow restrictions, cooperative R&D).

Technology and economic competitiveness was used as a term of reference to cover various productivity, quality, free trade, cooperative ventures, and research and development (R&D) questions. Many surveyed executives expressed concern with technology as it relates to international competitiveness: "R&D activity has strong government involvement and is therefore a key element in directing industrial priorities." (See page 9.)

3. *Deregulation* (defined as further relaxation of regulations affecting business, e.g., financial markets).

Many responding companies foresee increased harmonization of government regulations across national boundaries. Some public affairs officers expressed concern regarding too-rapid deregulation: "If not carefully implemented, deregulation may deeply disrupt markets and competition with no appreciable benefit accruing to the consumer," comments one banker. (See page 12.)

4. *Environmental issues* (includes protection, constraints, toxic wastes, clean air, clean water, acid rain, and others).

European companies continue to respond to repercussions of the twin environmenal disasters of Chernobyl and the Sandoz fire at Schweizerhalle. The growing concern about nuclear energy has led to calls for the harmonization of environmental regulations. According to a German pharmaceuticals manufacturer:

> "National environmental regulations, if not harmonized on an EC basis, might well endanger competitiveness. The costs of environmental protection are politically, not economically, allocated. If harmonization does not occur, the negative aspects will be considerable, as costs are not recoverable." (See page 15.)

5. *Financial disclosure* (requirements regarding the release of company finances and operating results to the public, stock analysts, the media, etc.).

As companies expand their interest and involvement in cross-border mergers, they await with some degree of uncertainty for the outcome of pending EC proposals regarding financial disclosure and related issues. (See page 18.)

A more detailed examination of these issues and company commentary appear in Chapter 3.

Other Significant Issues

While the five key issues listed above proved to be the most significant for the companies participating in this study, the issues described below also received mention.

Changes in the tax codes are important to companies contemplating cross-border mergers; this has, for example, proved to be the most difficult issue to resolve in a pending merger between a Dutch and Belgian bank. Other pertinent fiscal questions relate to the taxation of capital gains in investment companies and to the introduction of new tax regimes for companies as well as private individuals.

Government investment decisions were faulted. One respondent noted, "Swings in government investment policy have major impacts on our markets, creating difficult cycles."

Ethics and the quality of products were linked by some

Issues Description

[Alphabetical, not rank order, listing]

A. Agricultural Subsidies

B. Community Issues (such as support of inner cities, minority problems, housing)

C. Company Health Care Costs

D. Deregulation: further relaxation of regulation affecting business, e.g., financial markets

E. Education and Business: aid to institutions; participation in the performance and structural aspects of the educational system

F. Employment Discrimination:

a. comparable worth/pay equity: the claim that the wage level of jobs of equal value should be equal and not affected by gender discrimination.
b. ethnic discrimination by race, color or religion
c. handicapped: training and provision of facilities to encourage employment of the handicapped.

G. Employment Security Issues: job termination, etc.

H. Environmental Issues:

a. protection
b. constraints
c. toxic wastes
d. clean air
e. clean water
f. acid rain
g. other

I. European Monetary System/Exchange Rates/Monetary Stability

J. Family Issues:

a. day care assistance
b. part-time work with prorated benefits
c. maternity leave as a disability
d. care for the elderly

K. Financial Disclosure: requirements regarding the release of company finances and operating results to the public, stock analysts, the media, etc.

L. International Trade

a. protectionist measures such as tariffs, non-tariff barriers, etc.
b. completing the Internal Market

M. Job Creation and/or Retraining: The effects of long-term changes in labor pool requirements

N. Mergers:

a. financing of mergers
b. creation of monopolies

O. Multinationalism and foreign control: the granting of incentives and concessions to foreign operating companies

P. Plant Closure Statutes: regulations regarding the closing of plants; strictures on location of new facilities

Q. Privacy: An employer's need-to-know in conflict with an employee's civil right to privacy

R. Privatization: expanded return of formerly government-operated activities to the private sector

S. Product Liability: the effects of liability insurance, and the development of alternative systems

T. Public Health Issues:

a. AIDS
b. drug/alcohol abuse
c. other

U. Worker's and communities' rights regarding disclosure by firms of potentially hazardous products or processes

V. South Africa: apartheid, disinvestment

W. Tax Reform in the U.S.: the impact of the 1986 changes in tax policy

X. Technology and Economic Competitiveness:

a. research support
b. tax credits
c. copyrights and patents, intellectual property rights
d. science and engineering education
e. cross-frontier data flow restrictions
f. cooperative R&D

Y. Telecommunications: (deregulation, cross-frontier data flow)

Z. U.S. Budget Deficit

respondents. According to one executive, the corporate image "includes the safety and reliability of our products and is crucial to our success. Our image and that of our products must be constantly tailored to meet our present and future market needs."

The pharmaceutical companies almost uniformly described what they see as one of the primary threats to drug research: "The fact that drug pricing regulation is arbitrary in most countries leads to severe distortions. This results in trade between countries that takes advantage of artificially low prices," an executive of one such firm reported.

Product liability litigation in the United States hampers some European firms with operations there. "*Realistic* product liability in the United States is a problem of utmost importance to us. So far we have not introduced a few products in the United States because of the danger of unrealistic product liability claims," says one consumer goods manufacturer.

Chapter 3

Company Commentaries on Key Issues

International Trade

Some analysts are concerned that the postwar economic expansion spurred, in part, by the global movement toward freer trade may gradually be replaced by bilateral agreements between countries or within industries, citing, e.g., the pending trade agreement between the United States and Canada. A Dutch banker observes:

> "If you belong to a small country, you are a very firm believer in multilateral agreements. It's the only sensible solution for our world. And when you look at the ways that were used to handle the currency fights between the American administration and the German Bundesbank and the Japanese, you become convinced that you are much better off discussing those problems around the table of the IMF than going the bilateral route."

Survey respondents emphasized that protectionist pressures to erect new barriers around the EC market may well increase. Indeed, some governments and companies are already calling for a transition period in which existing restrictions on overseas competition will remain. "We in France fear the United States and Japan will attempt to resolve their trade disputes by focusing on Europe as the export market. More aggressive marketing in Europe by America and Japan may increase the risk of barriers in Europe. Europeans don't want to pay for U.S.-Japan bilateral trade problems," commented a French Ministry of Industry official.

Barriers could multiply in the banking and automotive sectors. There are currently restrictions on Japanese automotive imports in five of the 12 EC member countries. European automotive manufacturers are lobbying vigorously for tighter quotas on imports. As an Italian automotive executive commented, "We want to keep Japanese imports at one million. Last year Japan sold 1.2 million trucks and cars here. That's 10 percent of our market. We can't keep our plants going if Japanese imports continue to climb."

Among other sectors enjoying protection are Europe's postal services, which in some cases include telephones and cable television. These national services seldom have domestic competition, no less competition from abroad. Critics of any form of protectionist barriers cite the historical evidence: "Look at the Common Agricultural Policy. It is the EC's most elaborately developed set of regulations and has hopelessly complicated global agricultural trade," noted a German banker.

The EC's position is that markets are unlikely to be captured precipitously by either U.S. or Japanese firms. However, some markets, an EC official says, have already been captured:

> "The Japanese consumer electronics companies are highly competitive and likely to benefit from the internal market. The analysis at the moment is simply that they are already benefitting, so the internal market won't, of itself, solve the problems. What it will do is give European companies a wider competitive base. Domestic producers always have an advantage in terms of their own stock, the transport costs, and absence of internal tariffs."

Respondents also sensed strong protectionist pressures in some sectors of the U.S. economy, particularly manufacturing, where job losses and bankruptcies are often blamed on overseas trading practices. These pressures are reinforced by the 1987 U.S. $170 billion trade deficit—which included a $27 billion deficit with Europe. Critics of the current GATT round say the world has changed, but that the U.S. outlook and U.S. institutions have not. Some American observers say that more and more of the problems U.S. companies face may not lend themselves to resolution under GATT.

But Europeans disagree: "Some of us are quite distressed that the current administration in America persists in a strategy of bilateral agreements despite the lessons of history. We believe that bilateral agreements such as the ones that America is beginning to entertain lead to inefficiency in markets, distortion, and bureaucratic nightmares for firms like ours," noted an executive of an Italian technology firm.

Some respondents pointed to the current round of GATT negotiations as an important element in the international trade picture. It is believed that GATT negotiators will regain credibility if they achieve at least some provisional agreements in the key areas of intellectual property, business services, subsidies, and trade-related investment by the mid-term review at the end of 1988. Assuming that the 15 negotiating

groups continue to move systematically on their specific issues, these key agreements may actually be reached. (See box below.)

The CEO of a multinational telecommunications firm took a different view:

> "We would not characterize the U.S. government's position as favoring bilateralism over multilateralism. Certainly I think the U.S. government is taking bilateral initiatives but they view it as a second best option.
>
> "I think our corporation would much prefer a multilateral approach, while realizing that it is not always possible. Lacking the ability to reach a multilateral agreement, bilateral initiatives are probably the only feasible way to go. And in fact, if you speak off-the-record with representatives of the European Community, they too realize that this bilateral club that the United States is using is useful as long as it's not employed too often and as long as the EC is in a position to come in afterwards and get the same type of advantages for EC companies that the U.S. government is able to get for U.S. companies."

On the GATT Agenda

For most of the past four decades, the trading system that grew out of the post World War II period has served its partners well. The system is governed by the 1948 accord known as the General Agreement on Tariffs and Trade (GATT), an international code of commercial conduct to which 94 nations now subscribe. Under its rubric, member nations have negotiated seven rounds of tariff reductions resulting in an estimated 90 percent drop in tariffs over the past 40 years. In that same period, the volume of global trade increased sevenfold. Traditionally, services, such as banking and insurance, which now account for one-fourth of international trade, have remained outside the scope of GATT. But now, to the relief of the business community, GATT negotiators have entered new territory and are attempting to conclude agreements on several key issues, including:

Intellectual Property. There has been a ground swell of corporate support for the protection of intellectual property rights worldwide, even in some countries (e.g., Brazil, India) where resistance to a multilateral code of any kind is formidable.

It is widely recognized that inadequate intellectual property protection contributes to trade distortion. Some countries have no patent, trademark, or copyright laws. And even where there are laws, they may fail to protect entire categories of products or works, such as pharmaceuticals or sound recordings. Or they may provide for a term of protection that is too short to permit an innovator to test a product, have it approved by regulators, market it, and achieve a fair return on investment. In addition, enforcement of intellectual property laws may be lax and penalties for infringement so low that counterfeiters and pirates consider them a minor cost of doing business.

Many of the firms questioned for this report support a comprehensive agreement that would raise the aggregate level of protection or at least set minimum standards.

Government subsidies and trade-related investments. Negotiations on these issues will be among the toughest encountered, as the current row between the EC and the United States over subsidies to Airbus illustrates. (See page 10.) When national prestige is at stake, as well as billions of dollars and a desire not to be left behind technologically, countries do not hesitate to resist GATT discipline.

Agricultural subsidies are a formidable barrier. European farmers wield considerable political influence, and thus are protected from competition by subsidies, import barriers, quotas, and other trade-distorting practices. The EC's cuts in subsidies for dairy and meat producers were widely favored by the business community.

Trade in services. Companies trading in services across borders want a set of general rules and principles that would apply to such trade as a whole, as well as to specific sectoral agreements. Both the EC and the United States have introduced such proposals. The EC position calls for procedures without principles, while the U.S. proposal is essentially a declaration of principles without procedures. Somewhere between these two extremes, and with the recent U.S.-Canada Free Trade Agreement's binding provision on services as a precedent, a workable plan could surface.

Restoring Faith in GATT

To satisfy the business community, GATT negotiators will have to head off increasing unilateral government intervention in trade matters. To do so, GATT agreements will have to provide more in the areas of safeguards and of mechanisms for resolving disputes.

A case in point is the celebrated "Pasta War." In 1981, U.S. pasta makers complained that their European counterparts were gaining an increasing share of the U.S. market. They cited subsidies from the EC that violated GATT rules as the reason for the incursion. It took two years to get a ruling from a GATT panel, which found in favor of the United States. The Community, exercising its veto rights under the GATT system, then blocked adoption of the panel report and spent the next four years in on-and-off negotiations with the United States that also involved a separate dispute over citrus products.

During this period European pasta imports to the United States nearly tripled. The case was partly settled in August 1987, almost six years after it began, for a fraction of what the U.S. negotiators originally sought.

Some companies argue that unless dispute resolution mechanisms change, agreements in new fields will be useless. Skeptics were heartened by the recent passage in the United States of the three-year old trade legislation containing a measure giving the president specific authority to conduct GATT negotiations, advancing the liberalization needed to make the GATT a vital force once again.

Considerable progress was made in the first year of the Uruguay Round. Although it is too early for any tangible agreements, support for specific proposals in agriculture, trade in services, and intellectual property has been mobilized, especially within the EC, U.S. and Japanese business communities.

The executive cited as a case in point the agreement on intellectual property reached between the United States and Korea. He continued, "Certain retroactive provisions were made applicable only to U.S. companies and not to non-U.S. companies, and the EC quickly came in and told South Korea that if it didn't grant the same type of privileges to non-U.S. companies then some type of retaliatory action would be used. It is my understanding that South Korea has given in."

This executive believes that most European executives, if asked off-the-record, would say that the Commission would prefer to take these initiatives itself but can't because of the inherent problem in having to reach a consensus among the twelve Member States. "Therefore," he says, "We are fairly anxious to see the United States go out and do it. Then, the Commission can come back to the Member States and say, 'See what the United States has been able to do.' They have cut the ground, so to speak, now let's follow and get the same type of agreement."

Technology and Economic Competitiveness

As a British high-tech firm chairman commented, "Over three quarters of our sales are made outside the United Kingdom, increasingly from higher, value-added products. Thus our ability to be technologically and internationally competitive is essential to our objectives in running a world-class business."

Effective commercialization of new technologies is seen by European business as one of the leading factors in keeping Europe competitive. "Europe's greatest weakness," says the CEO of an industrial giant, "is the inability of our companies to bring new products to market."

Joint Research

Joint research projects, under the leadership of the Community, are geared to maximizing individual national efforts. The EC administers a $180 million fund designed to promote cooperation among research laboratories of the Member States. From the early 1980s onward, European firms looked to joint research as the mechanism for assembling the resources necessary to compete in the global R&D arena. Companies—particularly in the electronics field—are now hoping that their heavy involvement in collaborative research will pay off in the near term by closing the technology gap between Europe and its main industrial competitors. "We have failed to catch onto fast-developing new markets. We have lost out on new product development to the Japanese in consumer electronics and to Americans in computers," says a Dutch electronics executive.

The European Community's Framework Program for research and technological development runs from 1987-1991 and is designed to raise to the Community level those scientific and technical activities carried out in the Member States that would benefit from the optimal use of joint resources. The activities are divided into several major groups, e.g., quality of life, energy and resources, and industrial competitiveness. Among programs in the latter group are Esprit (European strategic program for research and development in information technology); RACE (Research and Development in Advanced Communications Technology for Europe); Brite (Basic research in industrial technology); Euram (European research in advanced materials); and those for raw materials, steel, and industrial norms and standards. (See box below.)

European Community Research and Technology Programs

Esprit (European strategic program for research and development in information technology)

- Launched in 1984; designed to run for 10 years (1984-1993).
- First phase, completed in 1987, selected 225 projects utilizing 3,000 research workers from 450 participating entities.
- Second phase will extend and broaden the current programs in advanced micro-electronics, software development, advanced information processing, office automation, and robotics.

RACE (Research and Development in Advanced Communications Technology for Europe)

- In liaison with national post office and telecommunications authorities.
- Ensures the coherence of the different telecommunications systems and services in Europe.
- Enables the EC to move towards integrated broadband communications (IBC) based on integrated services digital networks (ISDN). The system would incorporate telephones, videophones, cable and pay television, data transmission, and electronic mail.

Brite (Basic research in industrial technology for Europe)

- The application of new technologies in industry, i.e., laser, computerized design, mathematical modelling and manufacturing (CAD/CAM), new techniques in joining, processing, and assembling flexible materials.
- Will service the manufacturing sector: automobiles, aeronautics, textiles, clothing, shoes, etc.
- Has financed some 200 projects.

Euram (European research in advanced materials)

- Aims to give Europe the capability to produce new materials for automobiles, construction, aeronautics, etc.
- First project covers work on ceramics intended for future generations of combustion engines.

Programs in Steel

- Encourages the technical research needed to boost the competitiveness of the steel-producing and steel-using industries.

Programs in Raw Materials

- One program seeks to improve prospecting techniques, mining technology, and ore treatment processes for metals and minerals. Another seeks to advance technology in recycling non-ferrous metals, urban, agricultural and industrial wastes.
- Boosts European timber industry productivity through biotechnology and improved forestry techniques; encourages the use of wood as a structural material, for paper-making, and as products for the chemical industry.

The 12 Member States have more than a million scientists, including 450,000 research workers. However, the scope of their efforts is often reduced by a scattered allocation of resources, the lack of coordination of research work resulting from the isolation of research teams, and little diffusion of information. This results in duplicative national programs. The joint programs were designed to overcome these handicaps. They operate on the basis of shared costs; the EC contributes 50 percent of the cost of work carried out by research centers, universities, or companies operating under the programs. The programs are seen as the instruments for medium-term planning in research and technology. They have two main objectives:

- To maintain and strengthen European competitiveness, vis-a-vis the United States and Japan, in the high value-added technology sectors; and
- To improve the cohesion of European economic development by reducing disparities between Member States in the scientific fields.

The Framework Program sets general objectives and priorities as well as the financial allocations. (See Figure 2.) The programs themselves fall somewhere between basic and applied research, what may be called "finalized basic research" or "precompetitive technological development." They are not as market-oriented as the strictly competitive Airbus or Eureka projects, which deal with the development of goods and services demanded by the market.

"We are happy to see the shift in Esprit's direction towards product development. There is a new emphasis on competitive markets and the ability of the private sector to commercialize new technologies," a German pharmaceutical executive commented. "Much as America fears being left behind in the global technology race by Japanese and other Pacific Rim countries, so Europe fears being left behind by the U.S. and Japan."

Skilled Workers

The unemployment figures in Europe are always questioned, and this study was no exception. Skepticism was voiced about official unemployment figures, which range from 16 to 20 million, with respondents referring to the "black economy" and assigning millions of workers to it who are officially registered as unemployed. There was no argument, however, about the continued need for well-trained technical personnel for entry-level jobs. High-tech manufacturers and electronics companies foresee shortages ahead in the availability of people with science, mathematics, and basic computer skills. Such shortages will have to be solved within national boundaries, since business executives do not anticipate extensive migrations of workers when barriers among EC member countries are dropped. According to an executive of a Belgian high-tech company:

> "We estimate that there will be some migration, but it's not going to be a revolution. You should remember that it is already possible for a number of professionals to move; doctors and nurses can freely move. Recently, the British undertook a study as they were especially afraid, because of their low salaries and high qualifications, that doctors and nurses would leave the United Kingdom and start working on the Continent. But that hasn't happened. It is only in places where workers are forced by unemployment, like in Ireland, that they will move. You'll see a lot of Irish here in Brussels—young, highly qualified college graduates that have come here to work because they just cannot find a job in Ireland.
>
> "You have to remember, that no matter what the Community is doing to free-up the movement of individuals, you're always going to have friction provided by the different languages. You're not going to have Italians packing up and all learning Spanish to move to Spain. You see there are certain cultural barriers and these barriers will be felt especially among blue-collar, less-educated workers, the ones who really suffer from the restructuring of their industries."

Other Problems

Other technology and economic competitiveness issues raised by survey respondents included the inability to innovate, the lack of venture capital, and the difficulty in executing mergers. A representative of a U.K. food products firm states, "We cannot innovate quickly enough. Our firms are either too big, and therefore too bureaucratic, to move swiftly, or—as in my case—simply not large enough to command the resources we need."

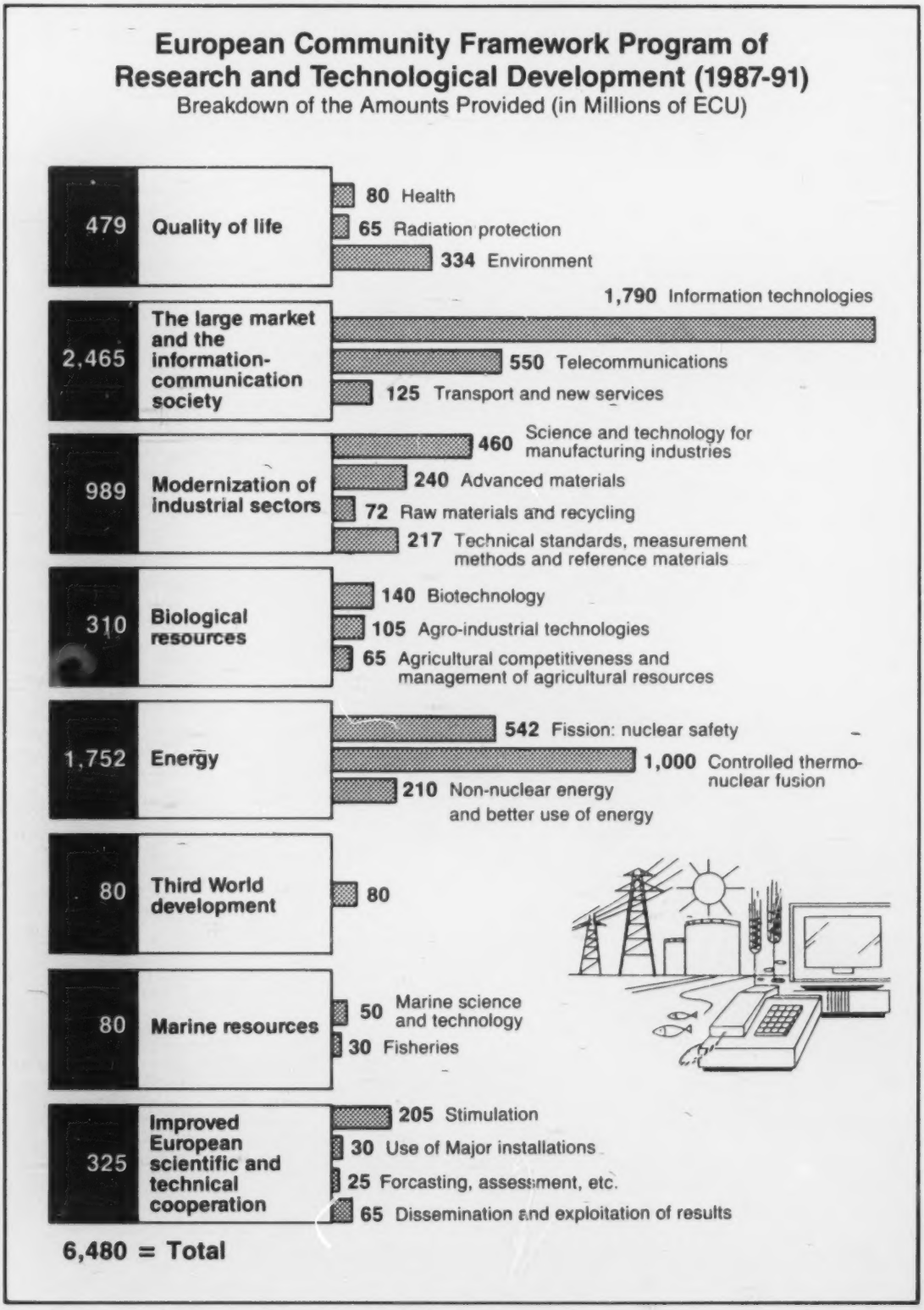
A French electronics executive noted, "Basically, we do not seem to be able to step into new markets quickly enough. Also, protectionist policies plus a lack of available venture capital puts us at a disadvantage. Even when this is not such a problem there are other difficulties with Europe-wide collaboration. Look at the example of Siemens and Philips, the leaders in semiconductor technology research, having formidable difficulties including the Italian-French group SGS-Thomson in their alliance."

Cooperative Ventures: The Airbus Model

Cooperative ventures are expected to increase in response to the creation of a unified market. (See Chapter 5.) Although Airbus Industrie is the most widely discussed partnership among European governments and companies, it is not likely to be the model followed in the 1990s.

Established in 1970, Airbus was designed to pool national resources in an effort to provide Europe with a viable and credible aircraft industry, one capable of competing with the dominant U.S. manufacturers. Sharing the risks and burdens so as to keep them at a tolerable level are four companies: Aerospatiale in France, Messerchmitt Boelkow Blohm (MBB) in West Germany, British Aerospace in Great Britain, and CASA of Spain.

Figure 2: European Community framework program of research and technological development (1987-1991)



Source: Commission of the European Communities, December 1987

Although the partnership can point to specific gains, the European states have grown tired of carrying Airbus. After 18 years of subsidies, Airbus's target date for profitability, the mid 1990s, will not be met. The weak dollar does not help, since revenues are in dollars and 75 percent of the costs in European currencies. To deal with this, the partners are considering shifting part of production from Europe to the United States and/or Southeast Asia, locations which offer much lower production costs than Europe.

Airbus continues to retain strong political support. It was designed to give Europe high-tech jobs and products and currently employs 1,250 people. It has 71 customers, 400 planes in service, and has managed to capture a world market share of nearly 30 percent. The heavy subsidies provided to Airbus by the participating governments has raised protectionist sentiment in the United States. Since early 1986 the United States has been calling for an end to such subsidies and is threatening a trade war over the issue. In response, the four European ministers responsible for the aircraft consortium directed the company to enter into a joint enterprise with McDonnell Douglas.

The European consortium and the U.S. firm would design and manufacture a new plane, substantially different from their current models and sufficiently threatening to their competitor, Boeing. Shared risks and pooled expertise would help spread the burden of financing the venture.

In May 1988, Airbus shifted talks from McDonnell Douglas to Lockheed. These talks are expected to be easier because Lockheed, unlike McDonnell Douglas, is not a competitor for Airbus, having left the civil airliner business. Some observers claim these talks are in earnest, as the four consortium backers are eager to bring Airbus costs under control. There is suspicion, however, among some U.S. business and government leaders that this latest move is a political exercise designed to cool U.S. complaints about subsidies and to avert a trade war.

The July 26th crash of the computer-controlled Airbus A320, even though attributed to pilot error, presents another problem. The new plane, which crashed and exploded while on a demonstration flight, was designed to compete with U.S. aircraft for the expanding short-haul jetliner market. Its sophisticated electronic controls and improved fuel economy are expected to give it a strong competitive edge over U.S. rivals.

Deregulation/Financial

"Changing patterns of regulation have involved both liberalization and stricter controls, making it abundantly clear that we need to understand the net effects," warns a French financial services executive. Banking sector respondents expressed the strongest concern regarding regulatory issues, especially with respect to the regulation of capital markets. Thus, the June 1988 decision of the EC's finance ministers to liberalize capital flows was welcomed. The new regulation would lift all remaining controls on both short-term financial transactions and direct and equity investments, and complements other measures to expedite cross-border financial services. It also would end restrictions on capital flows to non-EC members, like Switzerland and the United States. A Brussels-based banker comments: "Foreign trade forms 70 percent of Belgian GNP. Payment systems and the financing of trade is of primary importance to us."

In some countries, the amount of foreign currencies that companies can hold is limited by regulation; companies have often complained about such controls. In addition, the penetration of cross-border markets has been hampered by limitations on the size of foreign checks companies can cash without governmental authorization.

As of now, regulations on capital movements vary from country to country. The Netherlands, United Kingdom, and West Germany have relatively few restrictions on investment abroad. Belgium and Luxembourg still operate a dual exchange rate system, which they stand ready to phase out. Denmark requires official authorization for foreign investment, but it is easily obtained.

France and Italy are the most restrictive. France limits both domestic lending to non-residents and the opening of bank accounts abroad by residents. France is therefore fearful that after 1992 wealthy citizens will move their savings and investments abroad, looking for ways to evade taxes. Italy as well is concerned that there will be a massive outflow of capital; Italian banking regulations make it difficult to own property abroad. A Milanese textile executive comments:

> "Currently, in Italy, you have to leave a deposit—without any interest—of 15 percent of the investment you need abroad. So, for example, if you want to buy in Spain or in France or in the United States, you have to leave 15 percent of the value of the investment in your Italian bank without any interest. So it is not convenient."

The liberalization of capital investment rules should change this. Danish and French concerns regarding tax evaders are assuaged by the promise of specific provisions by late 1988 to curb tax evasion, with approval of such plans by mid-1989. Italian and French concerns regarding capital outflows may be offset by the establishment of an emergency procedure that would allow countries suffering from a run on their currencies to reimpose capital controls for up to six months, albeit only with the approval of the Member States. Ireland, Greece, Portugal, and Spain—with relatively small national capital markets—will be afforded a transition period in which to gear up to full participation.

The last round of deregulation has renewed the debate on the effectiveness and desirability of a common European monetary system and the establishment of a European central bank. Although far in the future, this is not without problems for some member countries, who see in such a central bank an unwelcome loss of national sovereignty. (See discussion on page 14.)

As a highly regulated industry, banking presents a special set of problems for an integrated Europe. No matter what happens to country barriers, regulatory control will have to be preserved. For a long period, the EC struggled with the concept of centralized regulation in a new Community bureaucracy. But in a shift of direction, the EC has now introduced the "single banking license." This will allow any bank that has been licensed in a Member State to establish itself and market its services in any other Member State without further authorization. This concept will also be applied to investment services and parts of the insurance industry. One Belgian banker commented:

> "We look to the United States, where lines have blurred between banks and insurance companies; banks are selling life insurance, insurance companies now own brokerage houses. This kind of deregulation is certainly going to change our boundaries."

Small countries face a particular challenge. For example, there will be much more competition in Belgium because it is much harder for small companies in small countries to invest in the larger markets of Europe and compete with companies from France, Germany, or the United Kingdom. These competitors have larger sales, larger volume, and larger capital markets. The Belgian banker continued:

> "I think deregulating banks and insurance companies is a good thing. There are many products and many market segments that are very close to each other. For the moment, we attract savings; people can get ready for their retirement either by buying a mutual fund from us or they can go to an insurance company and get life insurance. For the moment we have both, the life insurance company and the commercial bank, in the same market to sell similar instruments. I personally think that we should try to do that together; it would make a lot of sense.
>
> "More change is happening in our bank because now we have an insurance company which has shareholder participation of 8 percent with the intent to bring it to 10 percent. The relationship is still very strained in Belgium because insurance companies are authorized to become shareholders of a bank, but we are not authorized to become shareholders of insurance companies.
>
> "I think this is going to change. Our regulating authorities seem to accept the fact that we plan to take a shareholder participation of 5 percent in the same insurance company that has shareholder participation with us. If you want good synergy you have to be on the same footing. It's changing, but it's a slow process."

The new rules are expected to lead to fierce competition among European banks for new customers. Strongly capitalized West German and British banks appear to be in the best position to move quickly. Foreign banks also will benefit from this liberalization. Some European bankers worry that Japanese and American banks (chiefly Citicorp and J.P. Morgan & Co.) may become strong competitors. One observer remarks, "I see this as setting off a deregulatory scramble that will result in nothing short of chaos."

Most business executives do not agree, and echo the Danish official who said:

> "We are not afraid of regulatory competition. This will force us to cut back excessive regulation. If we don't, we won't be competitive. It is certainly better having control in a bank's home country than setting up a centralized, super-regulator."

The European Monetary System and the European Currency Unit

Survey respondents attribute a share of the economic disorders of the last 15 years—seesawing speculative capital flows, volatile oil and raw material prices, trade imbalances, and related indebtedness—to floating exchange rates. The post-World War II stable exchange rate system gave way in the 1960s to the floating exchange rates favored by the industrial nations. Critics believe that the economic stability expected of these policies has not been realized, and once again interest has been revived in the possibility of a single European currency. This would be a major step toward integrating the internal market with related economic policies. A German bank economist comments, "None of this will work without an all-out harmonization of economic policies."

The current move to liberalize the flow of capital is likely to create more pressure within the European Monetary System (EMS) and to renew the debate over the creation of a European central bank, once thought to be very far down the line.

The European Monetary System, created in 1979 as a system in which eight member nations pledge to keep their currencies within a certain range, was Europe's response to international monetary disorders and was designed to provide protection for intra-European trade. The monetary reference unit of the EMS is the European Currency Unit (ECU), a weighted average of European currencies in relation to which all EMS currencies are defined. (See Figure 3, page 14.) It is not used as the main reserve and settlement instrument; national currencies retain their roles in these respects.

The ECU followed the example set by the International Monetary Fund (IMF), whose unit of account, the special drawing right (SDR), consisted of agreed quantities of 16 currencies in a "common basket." In the case of the ECU, each country is required to adhere to margins of fluctuation established around the "central" rates defined for each currency. Each central bank is committed to intervene in exchange markets to ensure that its currency does not exceed its prescribed limits vis-a-vis another currency. The ECU is being used today in two separate ways. One is the official unit used by the monetary authorities. The second is the private use by business and the public at large looking for a currency unit for cross-border transactions.

The recent success in the battle against inflation has given rise to renewed discussion of the need for a central bank. For

the last decade there has been consensus in Europe on the importance of a joint fight against inflation. Price rises have slowed to a rate that a number of governments regard as acceptable. This has resulted in complaints by EMS partners, chiefly France and Italy, that relative undervaluation of the mark and overvaluation of their currencies have forced them to keep money relatively tight, while at the same time creating German export surpluses. For France and Italy, efforts to keep their currencies from falling more than the system allows against the German mark has caused them to forego expansionary policies in order to hold down their own inflation rates. To compound the matter, some countries, notably France, have kept interest rates high to prevent their currency from falling against the mark. Critics of German dominance of the EMS fear that if big differences persist between countries' interest rates it could trigger speculative capital flows that would increase pressure on exchange rates.

Supporters of the central bank concept—chiefly Belgium, France, and Italy—are critical of what they term the West German Bundesbank's "obsession with minimizing inflation" and look towards a central bank's adaptation of a more growth-oriented monetary policy.

Much to the surprise of its critics, West Germany has recently shifted it former opposition to forming such a bank. One observer comments, "The Germans do not wish the D-mark to be the engine that drives the economy of Europe."

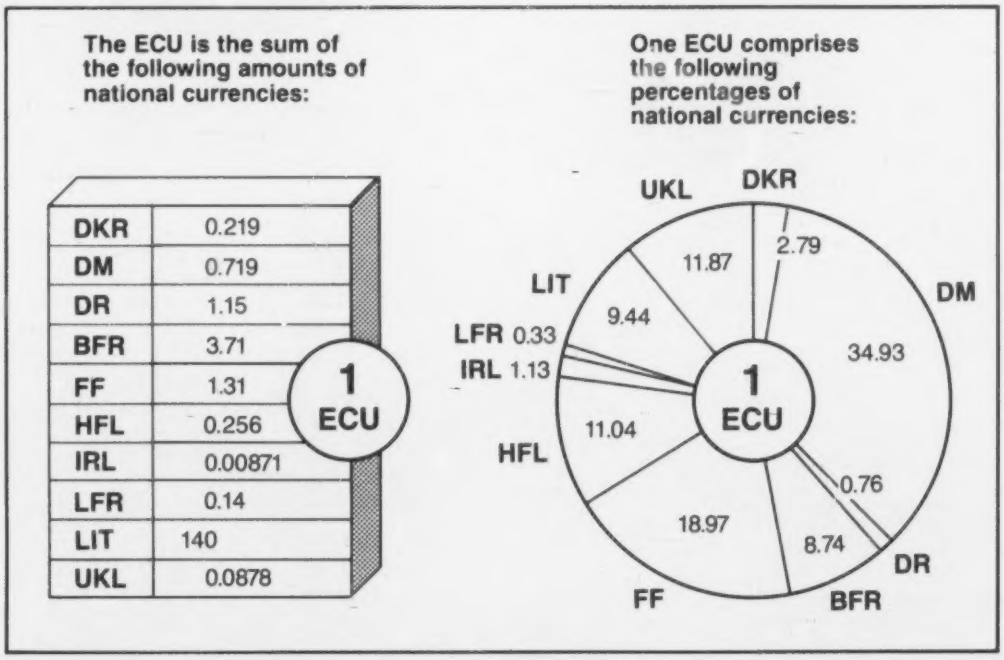
The establishment of a European Currency Unit, further strengthening of the EMS, and a European central bank are seen as the end products of the single European market. To the business community, a critical test of any government regulation is what it costs in time, money, and lost opportunities. Financial deregulation and the problems relating to Europe's multiple exchange rates were mentioned frequently by survey respondents in connection with the harmonization of economic policies.

The establishment of a European central bank is not without problems for some member countries, who see in such an enterprise an unwelcome loss of national sovereignty. Could such a bank coexist with national central banks or would it have to replace them? The British are conspicuously unwilling to give up the control which such a bank implies. Indeed, Mrs. Thatcher's total intractability on this matter has mystified many members of the Community.

The pound sterling is considered by some to be a petrocurrency, despite the fact that oil production makes up only 2 percent of Britain's GNP. This link to oil prices causes the pound to fluctuate, thereby requiring either intervention or leaving it to market forces. If the pound, so Mrs. Thatcher argues, is linked to other currencies it may be subject to a great deal of pressure because it will not be able to move fast enough in relation to events at home.

There is vigorous debate in Britain between Mrs. Thatcher, who insists that the pound be allowed to float, and her Chancellor of the Exchequer, Nigel Lawson, who argues otherwise. Mrs. Thatcher believes that a strong pound, which cuts the cost of imports, is one of the best ways to fight inflation. Mr. Lawson, on the other hand, contends that the pound cannot sustain its strength and eventually will undercut British industry and decrease the already low competitiveness of British exports. He wants to lower interest rates,

Figure 3: The ECU in relation to national currencies



Source: Commission of the European Communities, June 1987

make the pound less attractive to currency speculators, and lend stability to international markets. He advocates joining the EMS as a way of managing the exchange rate.

One Belgian financier commented:

> "We have arrived at a situation where the dollar can change its value because governors meet in New York and then at a certain moment give the impression that it (the dollar) has reached its proper level. Then they buy dollars and put them in the reserves of the national bank. In my opinion, it then becomes a political decision; it's no longer an economic problem anymore.
>
> "I am delighted that Giscard D'Estaing and Helmut Schmidt are pushing hard for the second stage of economic and monetary union in Europe. It is absolutely necessary that we have a European central bank and the ECU as a common currency. It doesn't make sense to have it any other way. These are very difficult decisions because when you say common currency, common federal reserve systems, it also means common policies. That's the real problem, you can't avoid it, and it has been the problem on the table since the beginning of the Common Market."

The finance executive questioned whether Europeans will accept this. He said:

> "I was very surprised to see the position the French Socialists took. When they came to power in 1981 they followed a nationalistic view, not even trying to find out what was happening outside their borders. Moreover, they had a philosophical view of what they thought socialism should be. It was a catastrophe, and the French economic policies have changed. I personally believe, wrongly or rightly, that there is now a stronger will among the citizenry to build Europe than there is among the politicians.
>
> "I am convinced—I think that many people are convinced now—it's the only solution. We have to move ahead, otherwise we're going to fall further behind America and Japan. If we don't do something we're going to lose."

Environmental Issues

Companies reported a range of involvement in environmental issues. Approximately one-third reported being actively involved in toxic waste disposal, clean water, and clean air issues. Only 13 percent listed acid rain as an area in which their firms were actively involved.

Toxic Waste

Europeans decided 15 years ago that the creation of toxic waste dumps, landfill sites, ponds, pits, etc., was both costly and unsafe. As discussed in a recent book by Piasecki and Davis, *America's Future in Toxic Waste Management: Lessons from Europe*, several land-conscious European countries have instituted policies aimed at recycling and high-temperature incineration.

> "In 1973 Denmark established the Kommunekemi facility in Nyborg, which now destroys over 70 percent of the nation's hazardous wastes. This integrated treatment facility also recovers heat from its toxic waste incinerators to supply Nyborg's 18,000 residents with 35 percent of their heating needs. Five years earlier, local governments within the West German state of Bavaria established the earliest hazardous waste treatment center in the world. With almost twenty years of operating experience, Bavaria's ZVSMM facility contains treatment components many Americans now hope to site and finance. Other European governments, including Sweden, Austria, Finland, and the Netherlands, are following these early examples by minimizing access to dumping and requiring the use of recycling, incineration, and treatment technologies."[1]

In some countries, hazardous waste management is seen as a public-private joint venture. Many nations are able to integrate sophisticated technologies, public policies, government and the private sector in their waste disposal plans. However, comprehensive common policies among European governments have proven elusive; efforts to coordinate environmental policy fall victim to the same national interests that hamper attempts at other regulated areas, such as the airline industry.

Environmental disasters do not respect national boundaries. The pressing need for comprehensive Europe-wide policies can be seen in the consequences of the November 1986 chemical fire at the Sandoz warehouse in Schweizerhalle, near Basel. The water used to fight the fire reportedly washed 30 tons of agricultural chemicals and 440 tons of mercury into the Rhine River. It killed fish and poisoned other river life from Basel to the North Sea, affecting Switzerland, France, West Germany and the Netherlands.

The Rheinwater Foundation in Amsterdam reported at the time that there were between seven and 15 smaller accidents every year involving German or Swiss chemical producers with plants or warehouses along the Rhine. Emergency plans to contain accidents are difficult to arrange. In Basel, for example, local cooperation for emergency preparedness involves authorities of three different countries: France, Switzerland, and West Germany.

Even before the Sandoz fire, the chemical industry had been tightening up its safety procedures—especially since 1976, when the explosion at Seveso, Italy released a cloud of toxic chemical dioxins. The ensuing scandal involving the removal and disposal of Seveso's contaminated soil led to the tightening of rules on waste shipment in Europe. The EC's "Seveso Directorate" became the model for Switzerland, which is considering aligning its antipollution regulations with those of the Community. But most of the safety regulation effort prior to 1986 was directed towards production and not storage. Immediately following the Schweizerhalle fire, a corporate strategy planner for Sandoz commented:

[1]Bruce W. Piasecki and Gary A. Davis, *America's Future in Toxic Waste Management: Lessons From Europe*, Quorum Books, Westport, Connecticut, 1987, p. 5.

"One has to differentiate between warehouses and production facilities. Previously, we were primarily concerned with production and the possibility of problems there. But now we will have to concentrate on questions of warehousing too."

Indeed, as Swiss officials acknowledged, rules need to be tightened regarding the storage of dangerous chemicals. See box below and on page 17 for one company's response to these concerns.

Comprehensive EC Policies

The first two European Community action programs, launched in 1973 and 1977, were concerned with remedying existing industrial pollution. The third action program, begun in 1983, developed an overall preventive strategy for safeguarding the environment and natural resources. That is, environment and natural resources considerations were to be woven into economic planning. The fourth action program continues this strategy with what is hoped will be a more effective integration of environmental policy with other Community development polices. Former Austrian chancellor Bruno Kreisky, in a recent report on Europe's unemployment problem, has gone as far as to suggest that jobs can be found for many of Europe's 16 to 20 million unemployed through a program to clean up industrial pollution in both the East and West blocs.

The integration of economic and environmental policies will involve setting stricter environmental standards in the context of the completion of the internal market. However, only some regulatory issues will be tackled; for example, there is no EC plan to iron-out health and safety at work.

The environmental regulatory changes anticipated in 1992 will only relate to trade between Member States. A good example would be motor vehicle emissions, since automobiles are traded across borders. Emissions from a power station, however, would not be subject to internal market regulations. Although there may be desirable environmenal outcomes to such strictures, these regulations would infringe on national sovereignty.

Some problems may actually be exacerbated. The German government, for example, is determined to protect its high standards of environmental protection and industrial safety

Ciba-Geigy's Principles for Environmental Protection in Production

Note: The following principles were approved by Ciba-Geigy's executive committee on May 23, 1984 and became valid worldwide for all Ciba-Geigy companies.

1. Protection of the environment is an important and determining factor in the manufacture of our products.

Our Commitment. As a consequence of our commitment, the group-wide running costs for environmental protection exceed 200 mio Sfr. p.a.; annual investments amount to approx. 200 mio Sfr. (10% of total investments).

2. We endeavour to solve potential environmental problems at their origin. To this end we manufacture our products using production procedures compatible with the needs of the environment. Whenever possible, reusable materials are recycled into a production process.

PPP = Pollution Prevention Pays: As a fundamental objective, environmental problems must be solved at the source: We must apply integral thinking in our process development work. Maximizing yield of desired products, recycling by-products and wastes whenever possible, reducing the energy consumption of chemical production are all aspects of this fundamental objective. Nevertheless there are limits to what we can achieve.

3. For the elimination of byproducts and wastes we use technologies which limit the impact on the environment to an acceptable minimum.

100% Recycling—impossible in specialty chemicals. Despite integrated process development, the production of specialty chemicals without any waste at the source will not be possible. As a result we apply modern and efficient pollution control technologies in order to cope with the problems of air pollution, effluents and solid wastes. In-house, we are developing new technologies in order to improve efficiency.

However, even applying the most modern and most efficient pollution control technology there will still be some discharge to the air, to the water bodies, to landfills. Zero discharge is an unrealistic objective.

4. Every employee, in the context of his duties, carries a personal responsibility for environmental protection. We encourage and further his training and instruction.

Paramount—clear responsibilities. Environmental protection is a joint effort of all our employees. Sound solutions are often the result of team work. It is most important that responsibilities are clearly defined at all levels.

This also means that our employees must get appropriate environmental training; we place heavy emphasis on such on-going training programs.

5. We inform our employees, our customers and the public about our measures for the protection of the environment.

Cooperation, not confrontation. Our company is part of society; contacts with our social partners are essential. Information must be a two-way street: we must inform about our problems and our solutions, and we must listen and respond to the needs of society.

The authorities must know about major unsolved problems and must be able to judge our efforts.

6. We seek and foster an open cooperation with the relevant public authorities.

in the face of possible lowering by the EC. Environmental activists—and EC officials as well—complain that environmental policies appear of marginal interest to most Member State governments. Although broad in scope, Community environmental programs lack financial resources and manpower.

Public Actions

The general public's involvement in environmental issues is less formal than in the litigious United States, where citizens' groups often initiate court action and request full disclosure of relevant documents. European governments do not have anything comparable to the U.S. Freedom-of-Information Act. Nevertheless, there are tools available to environmental groups and these tools vary widely from country to country and from issue to issue.

Ciba-Geigy's Internal Response to the Sandoz Fire

"The Sandoz fire has prompted us to again review our activities. While we feel that our basic approach to environmental protection in production continues to be valid, we are nevertheless, on the technical level

- putting additional emphasis on the prevention of ecological consequences from accidents,
- re-examining ecological risks of our stocks/warehouses,
- reviewing production processes, locations, product ranges.

"On the communication level: The event of November 1st has led to a drastic reduction of the acceptance of the chemical industry. We are increasing our efforts to let the outside world know what our problems concerning environmental protection are, how we intend to solve them, and what our objectives are. Being open to any constructive dialogue, we consider intensified communication as a necessary supplement to internal actions.

"Have all problems been solved?

"The answer is a clear No!

"We continue to learn from unexpected accidents, but also from new insights into ecology and from new analytical techniques.

"On the technical side: We continue to increase the efficiency of effluent treatment. In particular we must reduce the quantities of residual non-biodegradable discharges. New investments in this area are on the way. We must further reduce losses of solvents used in chemical production into the atmosphere. And we must solve the problem of special wastes. Chemistry with no solid wastes at all is impossible. On the other hand, society will not accept landfilling as a method for treating these wastes. For some time, therefore, we have put heavy emphasis on total destruction and mineralization of organic wastes, and massive investments for new modern incineration facilities are on the way.

"We believe that the chemical industry, emphasizing a holistic approach considering the long-term, must and can continue to contribute to society without undue harm to the environment."

Among the issues affecting the business community that have been influenced by local citizens groups and the more professional environmental groups are chlorofluorocarbons (CFCs), nuclear energy, and agricultural wastes.

Two of the most important environmental and consumer groups in Europe—the European Environmental Bureau (EEB) and the Bureau of European Consumer Unions (BECU)—are pressuring the EC to take action to protect the ozone layer by virtually eliminating the production of CFCs. Environmental activists are calling for an 85 percent cut in the amount of CFCs released into the atmosphere over the next five years, and for a complete ban on their use in aerosols.

The EC is encouraging Member States to sign and ratify two global agreements reducing the production and use of CFCs: the 1985 Vienna Convention for the Protection of the Ozone Layer and the 1987 Montreal Protocol. Most of the EC members have signed and ratified both agreements, with the exception of Ireland, Portugal, and Spain.

Under the Montreal agreement, both the production and consumption of CFCs would be frozen at the 1986 level, then gradually cut to achieve a 50 percent reduction by 1998. Forty CFC-producing countries have become signatories. If 20 countries ratify the Vienna Convention, the reductions agreed to under the Montreal Protocol will enter into effect.

The business community has responded. Petroferm, Inc. and American Telephone and Telegraph have developed environmentally safe chemical substitutes for CFC 113, which is used to clean electronic equipment and accounts for 17 percent of the CFCs produced worldwide. Other affected industries include the producers of packaging, insulation, refrigeration, and air conditioning.

The nuclear accident at Chernobyl has inspired a reevaluation of nuclear energy, which is a major energy source in Europe. Following the Chernobyl tragedy, "green" parties, and organizations such as Greenpeace and Britain's Friends of the Earth, announced steep increases in membership. Major political parties, like West Germany's Social Democrats, have taken positions against nuclear energy. Sweden has decided to phase out nuclear energy by 2010, even though it is the energy source currently supplying 42 percent of that country's electricity. In Italy and West Germany, attempts have been made to either ban or severely restrict nuclear power. The Netherlands, Switzerland, and Yugoslavia postponed or cancelled planned nuclear plant construction in the wake of Chernobyl. France, receiving 65 percent of its power from nuclear generators, and Belgium, with 60 percent, have taken the least action in this regard.

One permanent effect of Chernobyl has been an increase in emergency preparedness for nuclear accidents. The European nuclear industry is watching the fate of the Shoreham nuclear plant on New York's Long Island with interest. Although major construction on the Shoreham plant was completed in 1983, Lilco (Long Island Lighting Company), the operating firm, could not obtain an operating license

because the state and the county refused to assist in emergency planning.

The lack of an evacuation procedure was one of the key arguments of the anti-Shoreham forces; Long Island is a narrow peninsula with only one major highway running the length of the east-west axis, precluding speedy evacuation. The Three Mile Island disaster in 1979 reinforced the opposition's conviction.

By the time agreement to close the plant was reached, efforts to finish construction and open the facility spanned 22 acrimonious years and cost the company about $5.4 billion, or $2,000 for each resident of Long Island. The State of New York has agreed to take possession of the bitterly contested Shoreham nuclear power station and to dismantle it, but the legislature is balking at the agreement.

The nuclear industry worldwide was deeply affected by the controversy over the Shoreham installation. More than 100 nuclear plants have been cancelled since Lilco began construction in 1973; no new plants have been proposed in the United States in the last decade.

In the area of agricultural chemicals, the EC is moving to impose new controls on the agricultural use of pesticides and chemical fertilizers. It will be part of a general policy to substantially minimize the use of chemicals for agriculture, not only because of known hazards, but because of new fears about long-term effects.

There is bound to be controversy between those countries with strong environmental protection policies, such as Denmark, and those who believe that additional controls will hamper their competitive position.

A Danish producer of agricultural products has already been stung by public pressure:

> "My company has always had very good relations with our government and enjoyed an excellent press. We had our own program to reduce pesticide use by 20 percent over three years. I would often speak on television about this.
>
> "In late 1986 all this changed. Three, only three, lobsters were killed by fertilizer and pesticide outwash. But the 'man in the street' was so worried that the politicians responded. Our Parliament demanded a 50 percent reduction in fertilizer use.
>
> "My company, which had always been the subject of interviews on television, could no longer get television to give us any time to present our side and our plan. We were no longer considered trustworthy."

Financial Disclosure

So far the recent flurry of European cross-border mergers and takeover attempts has not succeeded in pushing the European Community's financial and regulatory machinery into high gear.

Proposals are pending in the Community for laws requiring investors to disclose stock ownership information and for giving the EC Commission regulatory control over big mergers. These proposals are meant to replace a welter of national laws. As to new legislation regulating takeover attempts, there is no agreement as yet on what the directive should contain. For example, should it require full disclosure of the terms of takeover bids? Should it regulate actual tactics in takeover battles, such as the use of so-called "poison-pill" defensive measures?

The momentous events of the past year in the European business world, the survey participants say, will certainly accelerate financial regulation in the Community. For example, in the Societe Generale de Belgique affair, Carlo De Benedetti was able to amass an 18.6 percent stake in the company before he voluntarily disclosed that he controlled the shares and planned to gain control of the company.

The proposed stock ownership directive would require public notification whenever investors acquire or dispose of at least 10 percent of a company's stock. West Germany and the Netherlands are firmly opposed, saying the disclosure requirement would add an unnecessary layer of bureaucratic regulation to their own national regimes. Some executives feel that disclosure of ownership of even 5 percent of a company's stock may be proposed. Furthermore, some commented that the proposed two-week lapse for disclosing a major stock purchase is too long.

Also unsettling to surveyed companies is the parallel activity under way in the U.S. Congress. Although the financial disclosure provision was deleted from the recently passed Omnibus Trade Bill, there is legitimate concern that the issue of additional financial disclosure for foreign investors in the United States will be rekindled in the next session of Congress. Fearful of retaliation abroad, some major U.S. corporations are vigorously lobbying against a requirement to have foreign investors disclose their identity and holdings in the United States.

General Motors, Caterpillar, IBM, and Amex are among the companies opposed. A new measure is expected to be markedly similar to the original. It would affect those firms with an interest of more than 5 percent in U.S. business, with real estate property assets of more than $5 million or sales of more than $10 million. Foreign firms with a controlling interest of more than 25 percent of a U.S. business with assets or sales of more than $20 million would have to furnish a balance sheet, an income statement, the location of U.S. facilities, and the names of company directors and officers. This ruling would reverse a history of U.S. respect for private property rights, including foreign-owned property. An executive of a Swedish company operating in the United States sees the bill as discriminatory, saying, "The Americans would require private foreign companies to disclose information not required of domestic companies."

An American executive opposed to the measure asks, "How can we expect other countries to lower barriers to investment by our companies if the United States raises barriers to foreign investment?

"In many cases it is necessary for our companies to invest in a foreign country in order to penetrate that country's market. If the United States exacts those kinds of controls, they

could lead to retaliatory measures that would result in the loss of U.S. business in foreign markets."

Takeovers and Cross-Border Mergers

Speculation about the direction financial disclosure regulations will take is likely to affect the character of merger activities. "Merger," in fact, will prove to be a more appropriate description than "takeover." This trend will be especially conspicuous among small, fragmented European industries, such as insurance and food manufacturing, which are expected to undergo large-scale restructuring. In the food industry, companies will look to dominate market share by buying up leading brand names, giving a new player in a European country instant name recognition. Non-EC companies, such as the Swiss, are considered better-positioned to make these moves than many EC-based companies.

If the De Benedetti loss is an example, European cross-border mergers will be characterized by agreed bids, rather than hostile takeovers. Continental markets tend to be less open than Great Britain and the United States, presenting political and structural defenses against hostile bids. With an array of family and bank holdings, nationalist fervor, "poison-pill" tactics, and, as in Italy, a handful of wealthy and powerful people controlling many companies through vast cross-holdings, friendly approaches will be the preferred route. Mergers increased in the Community by almost one-third between 1976-87 (see Figure 4), but activities vary from country to country.

While West Germany is very active in mergers, they mostly involve small to mid-size companies and have not received much attention. German executives are extremely uncomfortable with U.S.- and British-style takeovers. "There has never been a hostile takeover involving a German company. The cultural bias against them is too strong," commented an executive of a German pharmaceutical firm. On the other hand, foreign buys in West Germany climbed by 50 percent in 1987 to a total of 262.

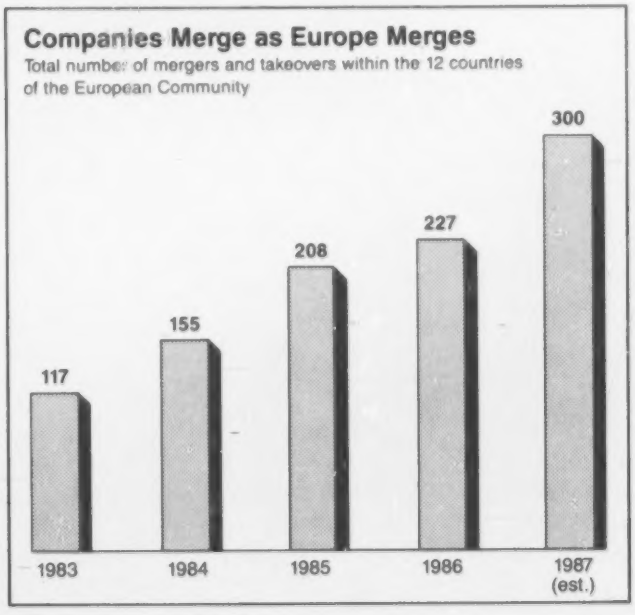
Belgium, Denmark, Italy, and Spain currently have mild merger-control laws. Britain is reluctant to give up national control; although considered the freest market in Europe, investors are protected by tough takeover restrictions. A bidder wishing to acquire more than 30 percent of a U.K. company must offer to buy the entire company, and the same per share price must be offered to all stockholders. British companies are protected further by the legal responsibility of a company director, which is to the shareholder. Conversely, in the Netherlands, a company director is obligated to protect the interests of the entire company, which includes not only employees but also customers and creditors. A Dutch public affairs executive comments:

> "We have not had an unwanted takeover in more than 25 years. Companies under fire have the ability to issue new shares and sell them to allies. Anonymous bearer shares are encouraged, making the location of major shareholders something of a mystery."

The Netherlands provides a home to some of Europe's biggest conglomerates, the result, in part, of its ability to resist cross-border takeovers. As mentioned earlier, Germany, operating under similar principles of rejecting foreign takeovers on national interest grounds, is also home to large conglomerates. Business leaders in the smaller countries fear that the new EC rules would permit powerful companies in Germany and the Netherlands to buy up their small companies, particularly in countries where strong antitrust laws have historically blocked mergers that would have built strong domestic groups.

Interestingly, the question of available capital did not arise among those surveyed; a shortage of money does not seem to be a problem. Bankers report that there is plenty of money available to would-be raiders with courage and sensible reorganization plans. A shortage of raiders is more to the point. Merchant bankers note that they can count the number of active European raiders on one finger.[2]

Figure 4: Companies Merge as Europe Merges



Note: Fiscal Years ending May 31.
Source: European Commission Directorate General on Competition.

New Merger Rules

Under the 1992 plan, the EC would review any acquisition within the market involving a company with annual sales exceeding 50 million European Currency Units (ECUs) and any group of companies with revenues of one billion ECUs.[3] The review panel would have two months to decide if it is

[2] From an interview in *The Wall Street Journal, Feb. 3, 1988.*

[3] *1 ECU = $1.25 on March 31, 1988.*

necessary to conduct a further, four-month antitrust investigation. Proposed mergers that appear to be in restraint of trade would be blocked. Business leaders fear that following such a six month review, the EC might still opt to throw difficult political decisions back to the national governments.

National governments will no longer be able to favor domestic bidders. A mid-size company that earns 25 percent of its revenues outside its home territory would be placed on equal footing with a larger outside company competing in a takeover battle on the smaller company's home turf.

The new rules are intended to replace the current array of politically expedient decisions, domestic disputes, and discrete precedent-setting court rulings. The general counsel to a major automobile company worries that they will only add to the bureaucratic process and not improve it. He calls for a "one-step process" to replace the current chaos. The antitrust laws, varying from country to country, provide the widest differences in expected takeover activity. An Italian financier sees his country's companies in an excellent position to launch takeover attempts and points out, "We do not have general antitrust laws. Fiat and Alfa Romeo together have captured 63 percent of the automobile market."

It is unclear whether the new rules would foster competition among companies or instead create a handful of European giants equal in size and scale of operation to U.S. and Japanese competitors. Airbus Industrie, which can be considered pan-European, has been, to some extent, a disappointment. (See page 10.)

Takeover tactics per se are not addressed by the new rules. Despite recent takeover failures, some European business leaders still anticipate a wave of U.S.-style takeovers. U.S. banks are now advising European companies on U.S. takeover tactics. Deregulation of financial markets, combined with technologically advanced information systems, has resulted in a new exportable American commodity—tactical advice on the less-than-friendly deal.

The European executives questioned commented most often on two problems connected with mergers: tax harmonization and national sovereignty.

Regarding taxes, a French banker remarked:

> "It is almost impossible to harmonize direct taxes since it would effectively lead to double taxation. This will cripple cross-border mergers. One way to solve this would be to approximize, rather than harmonize, indirect taxes."

A Belgian bank official commented:

> "The most important problem we find in mergers is still the fiscal problem, the tax difference between two countries. We have decided to form what we call an alliance that would bring us to a merger, if possible, in three years time with the largest bank in Holland. The fiscal problem that we face is to have one single bank where the shareholders would be on equal footing, be they Dutch or Belgian. I realize that fiscal policy is the prerogative of the elected government but without harmonization of taxes we cannot move forward.
>
> "That's one of the things that is on the list for 1992, to have uniform tax rules that will be applied to cross-border mergers. One way to do this is not just to merge the company, but create a new holding company that owns the other two companies and you then go to the tax system which is the most beneficial. For a Dutch-Belgian merger that would be the Netherlands. You may remember the Alcatel take-over of ITT: the company was established in the Netherlands, the headquarters was in Brussels, and the workers were in Paris. The headquarters is now leaving Brussels and moving to Paris, but it still is a Dutch company and under Dutch law for tax reasons."

Regarding the issue of national sovereignty, an EC official commented:

> "The reaction of the Belgian government to the De Benedetti case was very interesting, very chauvinistic. I hope in the future these international takeover bids will be considered more 'normal.' For example, in the United Kingdom, merger policy is based largely on the politicians' analysis of what is in the public interest, which is freely interpreted as the national interest. Currently, it may not be in the public interest to allow a French company to take over a British company. I think we shall see less and less of these national distinctions."

Strong feelings of sovereignty can both fend off a takeover and contribute to a company's vulnerability. A Belgian executive attempting to explain his country's reaction to the De Benedetti raid on Societe Generale, observes:

> "We have a very famous painting here called 'La Nuit Mystique.' It is a very beautiful painting. If somebody wants to buy Societe Generale, it would be like somebody trying to buy 'La Nuit Mystique.' It's part of the walls here.
>
> "The reaction was not necessarily anti-De Benedetti. Many hoped that Societe Generale would change because they were not so happy with the way it has been managed. The Flemish say that it's not sufficiently Flemish anymore, and, of course, Generale couldn't help it that the Walloons are no longer an economic power because there are no more coal mines and no more steel industry. So the Flemish say that it's not sufficiently Flemish, the Walloons say that the Generale didn't help the steel industry and the coal industry, and everybody thought that somebody new would run it in a different way. Now the methods that De Benedetti used were a matter of personal style; he didn't want to negotiate with anybody. Personally, I think he should have had a good friend in Belgium instead of doing it alone."

This executive is very much in favor of the pending EC laws requiring disclosure at a level of 10 percent stock ownership. The manager believes such a stricture would have "changed the whole picture." If the law had existed, it is reasoned, De Benedetti would have had to disclose his 10 percent ownership and at that point Generale could have increased their capital.

In all of this there is a certain irony, the executive says:

> "There was a Belgian law prepared with ten or 12 articles. Five were voted and then, unfortunately, our government fell on the parochial issues of the mayor not speaking Flemish. I'm sure historians will study this with interest. Here is the largest company, created before Belgium was a country, that could be so easily threatened because the government fell on the question of a mayor who refuses to speak Flemish."

Small to mid-size companies seem to have an easier time with takeovers and mergers than large companies. Britain's General Electric Company has not been able to acquire a continental company of an appropriate size and will continue to attempt joint venture agreements, despite its recent failure with Philips.

Some executives look beyond 1992 and believe that purely European merger strategies for coping with global competition will prove inadequate. They argue that focusing on 1992 and European integration will not be a strong enough response to the opening of markets around the world, to the need for research and development and manufacturing on a global scale.

Chapter 4
Unanswered Questions

Discussions with company executives raised questions regarding several areas that the business community believes to be insufficiently addressed in the 1992 plans. These are tax approximation, unemployment, and public procurement.

Tax approximation will probably be the biggest single problem area. One EC official comments:

> "There are centrally rooted difficulties that are going to take a very long time—if ever—to resolve. It will either become an all-consuming topic of discussion, or so watered-down that it's not going to be worth having an agreement. I fear that if we attempt to link a lot of difficult but achievable tasks with one really major, almost impossibly difficult task, we may drag down the entire enterprise."

The strict test—as for all 1992 regulatory proposals—is does the regulation affect commerce across borders? The White Paper makes no provision as to direct, or most forms of indirect, taxation. Even though company taxation or payroll tax affects the conditions of competition they do not "directly affect" cross-border commerce, according to the Commission. The EC is determined to harmonize value-added taxes (VATs) and to unify excise duties since widely differing indirect taxes would distort trade. This determination continues, even in the face of repeated calls for reappraisal.

The EC wants member countries to align their VAT tax rates within a reduced "band" of 4-9 percent for goods that governments want, for social reasons, to keep cheap, and a standard "band" of 14-20 percent. This is bound to make some unhappy. Britain, for example, would be required to levy VATs on some currently zero-rated items, like books, food, and baby clothes. The prices on these items would then be expected to rise steeply when European value-added taxes are harmonized. In Denmark, the price of liquor would drop by one-half, but it would rise in Greece by 145 percent. As regards approximation for taxation generally, Luxembourg would lose its most important industry, its tax-free haven for businesses.

The 16 million unemployment figure is widely disputed in Europe. Some say it is as high as 20 million. Nor is it generally accepted that high unemployment stems from "structural" problems, i.e., inflexible wage structures, uncompromising unions, and entrenched welfare states. The notion of "Eurosclerosis" seems to be fading. On the other hand, most agree that unemployment is a growing and seemingly intractable problem.

Some fear that unemployment may actually increase under the 1992 program as companies pare down to meet increased competition from foreign producers.

Paradoxically, while the ranks of the unemployed grow, companies are finding it difficult to hire qualified, entry-level people. As an executive of a multinational technology firm commented:

> "We have always had this problem in our industry because we are a relatively young industry. We do not have enough qualified people applying for jobs as specialists in computer science or as technicians in our development labs. We do not have such a problem in recruiting sales personnel for marketing."

A Belgian bank chairman concurred:

> "I have trouble finding good employees for my bank. When I say good employees I mean somebody coming out of a good secondary school and who can speak at least two national languages, has some notion of English, and the ability to calculate. The curriculum in Belgium is not adapted to present needs."

There has been a recent move to introduce a social dimension to market integration. At the European Trade Union Confederation Conference in Stockholm in May 1988, Jacques Delors, the EC's president, announced three specific proposals.

- The introduction of a "minimum threshold of social rights" to be negotiated between labor and management.
- The right of every worker in the EC to permanent training based on a system of credits over a lifetime.
- Changes in Community company law to develop worker participation in decision-making.

Public procurement policies are going to be particularly difficult to change. Member governments will have to open their public procurement process to firms in all the EC countries. A political leader commented, "We are losing a way to create jobs and to locate industrial activities in regions

that need it." A business respondent countered, "Politicians are going to lose patronage positions. That's all."

How the EC will deal with competition among Member States to attract investment is also uncertain. A CEO of a multinational pharmaceuticals firm wonders:

> "Some countries now offer special incentives to locate plants. This is not acknowledged by the countries, but we all know it occurs. What will happen to this [tactic] under the new rules? Is the framework covering pharmaceuticals and high-tech biotechnology going to eliminate this practice?"

Finally, the increased competition at all levels is expected to affect the policies that have long coddled protected national industries. "Certainly," one CEO comments, "the Commission is already very active in persuading governments to no longer support ailing industries. You will not see much enthusiasm for 1992 from these groups."

Agricultural subsidies have been the subject of bitter and prolonged debate. The most serious problem the EC faces is integrating the government-dependent agricultural sector; about 70 percent of the EC budget goes to agricultural subsidies.

Chapter 5
Country Differences, Company Strategies

As the industrial machinery cranks up for 1992, the differences in doing business among the various EC countries—and on the outside—will become marked. Once market barriers are reduced or eliminated, companies will focus more on lower production costs, and the attraction of doing business in cheaper member countries will increase. Some European countries are already courting foreign investment through tax concessions—with predictable results. Japanese companies last year invested three times as much in Britain as in West Germany, where the corporate tax rate is twice as high.

Tax approximation, as discussed earlier, will present serious problems for most countries. Ireland and Denmark would experience serious revenue losses as they are faced with reducing their extremely high indirect taxes. At the same time, when European value-added taxes are harmonized, the prices in Britain of certain goods that are currently zero-rated will rise sharply.

In addition to the taxation variables, the Community will still have 12 nations speaking nine different languages, spending 12 different currencies, and governed by a bewildering array of different laws.

The Insiders

Belgium

Despite its outcome, the Italian entrepreneur Carlo De Benedetti's takeover attempt of Societe Generale de Belgique is viewed by many as a very concrete example of where the European market may be centered after 1992. Brussels is seen by many analysts as the best place to do business after the barriers fall—it is the heart of the European Community. Expanding from a Brussels headquarters is perceived as offsetting the nationalist objections that might arise from takeover bids originating in Bonn, London, Milan, or Paris. As for takeovers themselves, a Brussels-based banker commented that "these deals will be the only way to make European companies big enough to compete with Japanese and U.S. companies."

Transport is the principal concern of a major telecommunication firm. More than 95 percent of their products sold in Europe are manufactured there. Their financial system is closely tied to the distribution system, because the plants in France deliver to the plants in Germany, which deliver to the plants in Italy, which deliver to the customer. But they have made no new changes in their operating structure to prepare for '92—it has always been part of the normal planning process for this firm.

France

There is a high level of awareness of 1992 objectives in France as a result of an intensive information campaign by the French government, which is trying to prod French industries to restructure in order to gain a competitive edge. The government has long felt France is not moving fast enough in export markets and remains too inwardly focused.

However, "Quatre-vingt-douze," or '92, will have to withstand a burst of nationalist fervor. Small business owners, farmers, licensed professionals, and blue collar workers are less than enthusiastic about the vision of a unified Europe—unless, of course, it were to look like France. During the last election, political leaders supporting 1992 goals proposed that the future capital of the Internal Market be Paris. In that direction, the French government has initiated a marketing effort to encourage multinational companies to locate their post-1992 headquarters in Paris.

Other nations appear more comfortable with the projected disappearance of trade barriers than does France. "Our companies fear 1992 more than anything else," say French business respondents. They see their companies as less competitive and their foreign distribution networks inferior to those of German companies. As a result, some French companies want to see from the inside how continent-wide distribution works in the United States; Air Liquide has been increasing its U.S. presence for more than a decade.

Other French companies are looking for partners. Matra, a French defense and electronics group, was privatised in January 1988 and sold small stakes to GE in Britain (not related to the U.S. company), Daimler-Benz of West Germany, and Wallenberg of Sweden, in an effort to coordinate support of defense systems development.

The acquisitions market has been particularly vigorous in France:

- The French insurance company Cie du Midi has bought the British insurer Equity and Law for $800 million.
- Rhone-Poulenc, a chemicals and pharmaceuticals firm, has made several acquisitions in Europe, including Natterman, a German drug company.
- Compagnie Generale d'Electricite, the French telecommunications giant, has acquired ITT Corporation's European operations.
- Thomson S.A., a French electronics company has bought Telefunken Electronic G.m.b.H. of West Germany.

Some problems may be exacerbated, rather than resolved, by the 1992 plans. Unemployment, for example, may actually grow under the new program; Peugeot plans to eliminate 4,000 jobs as it streamlines its operation.

Finally, a French banker sees national sovereignty getting in the way: "Closer ties of the home country to the EC will influence many of the important operating conditions of our group."

West Germany

Franco-German relations traditionally have been regarded as the cornerstone of the European economic and business community. They are watched as an indicator of European vitality. Recent differences between the two countries include antagonism over agriculture, West Germany's favorable response to the denuclearization of Europe, and France's continued belief in nuclear deterrents.

More relevant to the integration of the market is Germany's lack of enthusiasm for expanding the ECU, which German business sees as a threat to the mark. France, on the other hand, sees the ECU as an opportunity for a closer integration of European economies.

Some business leaders in West Germany have commented that they have the most to lose if Europe becomes a truly common market in 1992. West Germany's costs are high—the highest in Europe for labor, energy, and environmental controls. The strong mark makes investing in West Germany even more expensive for foreigners, who also find the nation's 70 percent corporate tax rate prohibitive. These handicaps will become damaging as competition intensifies and the dismantling of trade barriers diminishes the advantage of producing goods in West Germany, Europe's largest market.[1]

Among other worries is the potential for an exodus of West German production. For the first time in memory foreign companies liquidated more fixed assets than they acquired during 1987's first half. This trend is expected to continue if 1992 goals are realized and companies find more attractive opportunities elsewhere.

The Organization for Economic Cooperation and Development (OECD) expects the growth in industrial investment in West Germany to slow to 2 percent this year and to 1.5 percent in 1989, down from 3.25 percent last year. This decline prompted trade groups representing the nation's machinery and plant building industry to charge the government with a dangerous miscalculation as to the attractiveness of West Germany as a production site.

Despite the warning signs, "Chancellor Helmut Kohl and his finance minister, Gerhard Stoltenberg, are exasperating businessmen by clinging to a watered-down tax reform plan that many think will be too little and too late. Industry executives questioned say they want deregulation and deep tax cuts—and soon."[2]

A public affairs officer from a German pharmaceuticals firm says, "Our challenge will be to show that West Germany still has advantages: political stability, a skilled workforce that produces quality goods, advanced technology and research facilities, and low inflation."

Industry's advocates of tax cuts and deregulation are well aware that their demands go against their country's deeply entrenched social-welfare doctrine, which no German government forsakes—unless it is ready to step down.

Ireland

The national debt has been brought under control and exports are growing, but Ireland is still plagued by a 19 percent unemployment rate, with more than 30,000 workers per year emigrating in search of jobs. Ireland is producing a well-educated, skilled workforce, but is unable to provide jobs. "A period of transition will be needed before Ireland participates fully in the market," say Irish bankers.

Italy

Many Italian business leaders are looking forward to the new competitive arena. While industrial leaders mobilize publicly, in private they express concern regarding substantial public sector deficits and a weak banking system.

The Italian government is working to remove bureaucratic obstacles, foster competitiveness, and stimulate small to mid-size industries. A new competitiveness policy has as its goals the deregulation of many protected sectors, and the introduction of antitrust legislation.[3]

The public sector will also be trimmed. Some state-owned companies will be privatized, and others placed in the hands of independent managers who will be held responsible for efficient operations. Italy's new industrial policy calls for the standardization of legislation in accordance with EC directives.

Although Carlo De Benedetti is the most widely publicized Italian corporate raider, there are several others seeking somewhat more subdued alliances. Italtel, a

[1] From an interview with Norbert Walker, senior economist for Deutsche Bank AG, and others, as reported in *The Wall Street Journal*, March 8, 1988.

[2] Ibid.

[3] Adolfo Battaglia, Italian Minister of Industry, "Italy's Industrial Policy Challenged by 1992," *The Wall Street Journal*, June 27, 1988.

communications firm, is actively seeking a major partner, while Italian broadcaster Silvio Berlusconi, already in France, is looking toward Spain.

The Netherlands

For years Holland has enjoyed free cross border flows of capital and encouraged the participation of foreign financial institutions, but it is just beginning to feel the effects of deregulation, consolidation, and foreign competitiveness. The most apparent response is the proposed merger of Amsterdam-Rotterdam (Amro) Bank and Generale Bank of Belgium. This consolidation would make the new entity the largest bank in the Benelux group, the sixth largest in Europe, and well able to compete internationally.

Philips is perhaps undergoing the most extensive restructuring of any major Dutch company. The firm has announced a projected $100 million saving by various cost-cutting procedures, including job elimination. Europe's biggest electronics group, Philips—following a 19 percent drop in annual profits, increased competition from the United States and Japan, and new opportunities in Europe—is undergoing an extensive downsizing in preparation for 1992. Up to 20,000 jobs will be eliminated, the number of plants will be reduced from 170 to 100, and some production will be shifted to low cost dollar areas, such as Mexico. In addition, Philips and Siemens A.G., the West German electronics giant, have formed a $1 billion research project to develop semiconductors.

United Kingdom

The British press is beginning to relax its opposition to the internal market reforms of 1992. In this respect, surveyed executives say, the British press reflects, to a considerable degree, the government's position. Mrs. Thatcher's confrontations with European leaders at EC summits "lead us to clench our teeth in anticipation of her arrival," says one Community official. British business executives questioned also say that their lack of interest in 1992 reflects the government's attitude. Mrs. Thatcher, although accepting the integration of the markets in principle, has been less than enthusiastic. Nonetheless, the British are being nudged into 1992 via a campaign recently launched by the government. The decision to mount this campaign shortly preceded a study published in March 1988 by the accounting firm of Ernst and Whinney showing only 38 percent of senior corporate executives even being aware of the changes scheduled in 1992.

In another survey, released jointly in April by the Wall Street Journal/Europe and the management consulting firm of Booz-Allen & Hamilton, Inc., only 20 percent of the British companies polled plan to undertake mergers in 1992, compared with 31 percent of West German respondents, and 50 percent of the French. And while half of the French companies surveyed and one-third of the German have changed their cost structures, only one-fourth of the British have done the same.

Among those companies reporting on their merger plans:

- CAP, one of Great Britain's leading software firms, recently agreed to merge with its French equivalent Semi-Metra.
- Christie's International, the London auction house, following Sotheby's lead, plans to enter the auction markets on the Continent.
- Hillsdown Holdings, a U.K. conglomerate, bought three Dutch companies.
- British publisher Robert Maxwell, already operating a news agency in France, plans to expand his holdings.

Relaxations of rules prohibiting foreign financial institutions from purchasing local brokerage firms have encouraged major houses such as the S.G. Warburg Group of Britain to invest substantial sums in Spain and France.

ICC, the U.K. computer group, has a special project team, the European Strategy Board. It will control European acquisition and joint venture strategy, lobby for more open markets and for common technical standards, act as research and development managers for new products, and integrate road haulage and other transport with their information systems.

Greece, Portugal, and Spain

Business executives in these countries worry that West Germany will benefit most from a unified internal market. With the Germans already fiercely competitive, the breaking-down of remaining barriers to trade is seen as giving German firms an even greater advantage. Such a move would certainly relax the barriers to luxury cars that the German automotive industry currently faces with Greece, Portugal, and Spain.

Portugal and Spain, EC members since January 1986, are lagging behind the economic growth of the Northern Tier countries. Portugal, regarded as particularly insular, is seen as vulnerable to rapidly expanding Spanish firms. Busy rebuilding its infrastructure through the use, to some extent, of EC funds, Portugal is undertaking much-needed highway construction. Further improvements in infrastructure —water and sewer construction; the electrication of small villages; and the upgrading of railroads, bridges, cargo and fishing ports—are a must if Portugal is to compete efficiently with its neighbors.

Flexible workforce management—the right to dismiss workers—will be instituted in Portugal this year in the hope of attracting investment, therefore creating jobs. Fierce opposition is expected from the unions, but there is general agreement that reforms are needed if productivity and investment are to increase.

Businessmen in Portugal and Spain are concerned that they will be swamped by better-made, cheaper goods from Belgium, the Netherlands, and West Germany. Consumers in the Spanish cities, however, seem to be enjoying the flood of luxury imported goods from the Member States. Shops in Barcelona, Madrid, and Seville report business is booming.

But this is not the case in rural areas of Spain where the economy is fueled by farming and steel production. There are still extensive subsidies for out-moded plants and industries, and one-sixth of the Spanish workforce is located in small-scale farming operations. The dairy industry in particular is protected by production quotas, in addition to direct subsidies; it is less productive, less cost-effective, and said to produce poorer-quality products than some of its European competitors. It is feared that small farmers will be forced to give way to larger agricultural holdings. Integration in several sectors will be delayed for Spain, which has been given $300 million to modernize its infrastructure.

Spain is deregulating its securities industries and promoting mergers. As a result, AT&T (U.S.) and Philips Telecommunications (Holland) have formed a joint venture with Amper, a Spanish electronics producer, in plans to sell $200 million of equipment yearly to Spain's telephone company.

Spain has other problems: Spanish business invests little in research and development, operates in small units and has little experience selling abroad. Spanish industry is small and fragmented. Of all the Western European companies employing more than 1,000 people, only 5 percent are Spanish. Of companies employing less than 20 people, nearly 10 percent are Spanish.[4]

For Greece's participation in the Market the key elements are the commitment to strengthen economic and social cohesion and to advance some regions by reducing disparities between regions. By threatening to veto entry of Spain and Portugal, Greece won the largest share of Mediterranean development funds—$2.2 billion.

Non-EC Member Countries

Non-EC countries, both in Europe and abroad, are growing nervous about 1992. The European Free Trade Association (EFTA), comprised of six Western non-EC Member States, exports well over half its production to the Community. But Community members are saying privileges should be reserved for full members only.

Intra-Community activity is forcing firms outside the EC to acquire companies within Member States. Outsiders fear that consumers will discriminate against their products if they do not have substantial holdings within the Community. Some recent activities include:

- Electrolux, the Swedish appliance manufacturer, has an active acquisitions program, buying up dozens of companies annually in the last few years.
- Nokia, a Finnish electronics company, acquired the television business of Alcatel of France, in addition to 14 other smaller ventures.
- Nestle of Switzerland will acquire U.K. chocolate maker Rowntree PLC. British apprehension about layoffs was assuaged by Nestle's agreement to protect employees.

[4] From an address by Fernando de Asua, president of IBM Espana, at a conference in Madrid, May 10, 1988.

Countries previously content to remain outside are now rethinking that position. Turkey applied to join the Community last year. Austria and Norway are expected to follow. Finland, Sweden and Switzerland still say their neutrality prevents them from joining.

Swedish industrialists are worried about 1992. How will Sweden cope as a non-member when the Internal Market is completed? "Swedish exports will be particularly hit," says an automotive components manufacturer. "Forty percent of our market is in the EC."

Sweden is negotiating a special agreement that would allow it to trade freely with EC countries in exchange for conforming to Community regulations. Among the problems Sweden would have to overcome are exchange regulations, which hamper capital flow; tax reform, both to attract foreign investment and to keep Swedes at home (the top rate of income tax is 75 percent); and the inability to tap into the European labor pool to overcome the shortage of skilled Swedish workers.

Despite the fact that some Swedish business leaders believe it is in their best interests to belong to the Community, Sweden has continued to rule out membership.

As for the U.S. and Japanese multinationals, they may find themselves standing outside the gates of "Fortress Europe," attempting to scale the barriers surrounding the fledgling unification. The EC claims this will not happen; there will be no exclusions. For multinationals, competition may become tough, but they will also benefit from the freer movement of goods and people within Europe. Indeed, some companies have operated for decades as though Europe was a single market; IBM and Ford coordinate manufacturing and distribution from many factories through a single headquarters. U.S. business, accustomed to a huge domestic market, seems poised to take advantage of the removal of trade barriers. In 1986, U.S. exports to the EC were worth over $53 billion, twice the value of exports to Japan.

U.S. companies, as would be expected, are not as preoccupied with European economic integration as are European companies. The exceptions, of course, are U.S.-based multinationals with a strong presence in Europe.

- Among the U.S.-based companies, Texas Instruments, the U.S. semiconductor group, is establishing a single European distribution center. It will close its chip manufacturing plant in Nice, but will put additional investment into West Germany. Last year TI shifted its integrated circuit facility from the U.K. to Portugal.
- Minnesota Mining and Manufacturing (3M), the U.S.-based multinational industrial and consumer products group, has had a program of rationalization since the late 1960s. For example, they manufacture products for all of Europe in one or two plants. To move the rationalization process further forward the company has set up teams to reorganize its distribution practices from a national to a pan-European focus. The teams will also consider standardizing the firm's marketing literature for industrial products.

Europe provides 75 percent of 3M's international sales, which in turn represent 40 percent of the $9.4 billion annual group total.

- The Coca-Cola Company and the Gillette Company plan to reduce costs by running the same television advertisement across Europe with only the voice-overs changed. This will be possible because of harmonized standards allowing identical packaging in different countries, with instructions in several languages.
- Dow Chemical, with European sales of $5 billion, expects a cost saving of $50 million a year coming from the harmonized product standards and uniform requirements for product registration.

For Japan, the attractiveness of the large, European market will be offset by the fear of protectionist backlash. The Japanese auto industry already faces tough quotas in France, Italy, and Spain, whose restrictions will have to be abandoned in 1992. But the European auto industry as a whole is lobbying for an EC-wide quota of one million vehicle imports a year. However, if Japan enters into production in Europe, Japanese cars, provided they are made with a substantial number of European components, can be traded as freely as European cars.

Japanese auto manufacturers, already commanding 9.8 percent of the EC market, are determined to drive their market share up to 20 percent by 1992. Nissan has already announced a $400 million expansion for its Sunderland, England plant.

European economic analysts are not as uneasy about the United States and Japan as is the business community. The United States, French economists say, has let its manufacturing base deteriorate too much to pose a threat to Europe. The major reordering now taking place should produce big gains in productivity and the commercialization of new products—but primarily for European companies, they say.

Particular sectors, as well as individual countries and companies, are changing some policies and practices in preparation for 1992. In West Germany, protected sectors like the trucking industry are demanding guarantees. A chemical company, which in the past did not care whether its products were considered dangerous in countries to which it did not sell, has changed direction. The company's president comments, "In the past we suffered because public perception confused our products (essentially non-toxic) with other chemicals. An intensive public affairs effort has changed that and the confusion has been largely eliminated."

Some companies engaged in government contracts will have to change their style of operation. An EC official involved in public procurement policies says:

> "In public procurement there are many companies that rely to a great extent on their own national authorities, particularly their tenders. For example, if you have a power station or hospital, you are going to be very close to your own national power station authority, and, if you're the only major supplier for your particular country, you will probably win all the contracts. But by 1992 that will no longer be true. It is not only possible, but also a treaty right for firms of other member countries to compete for the contract. There will be a major change in procurement practices, and unless companies are prepared to face competition from other countries and seek out opportunities in those countries, then they are going to be severely disadvantaged when it actually happens."

Chapter 6
Querying Public Affairs Officers

To date, most of the information on 1992 has been made available by Member State governments. They have virtually usurped the corporate public affairs function and are informing the business community and the general public and urging them to get on the bandwagon. Firms are busy preparing budgets, new organizational plans, changes in sales forces and redefining product mixes. But as 1992 draws closer, public affairs officers will be gearing up to manage new groups of issues with a broader scope and more geographic breadth than ever before.

Public affairs officers assess and manage a variety of concerns that come under the rubric of public policy issues. Not only do they direct the attention of their senior management to the anticipated courses of action external to the company, but they also may recommend the allocation of staff and resources to manage these issues. One of their primary jobs is to develop the most productive and beneficial relationship between the corporate enterprise, the issues and the affected sectors of the general public. The Conference Board is interested not only in a corporations' concern about social, political, and economic change, but also how firms affect the legislative process and which efforts companies find most effective.

In selecting the issues to be included in this survey, researchers relied on input from The Board's European Public Affairs Council. The Council's advice formed the basis for the issues as defined on page 6.

How Companies Rate their Early-Warning Abilities

While more than one-half of the respondents rate their early-warning systems as "good," only 17 percent rate them as "excellent." Only one respondent rated his firm's issues identification process as "poor." (See Table 2.)

An executive of a Dutch manufacturing company emphasized the following:

> "It is very important to be able to distinguish 'issues' from 'trends.' A trend decides—or at the very least shapes—the outcome of an issue. Business ethics, for example, is a trend and increased attention payed to the ethical behavior of business leaders will shape the corporation's response to a broad range of social issues. The concern for environmental protection is a trend; how my company disposes of toxic wastes (and how we convey that to our public) is the issue. We are a large corporation with a diverse product range. We are too big to respond to change quickly. An early warning is essential to our executives so that they can re-allocate staff and resources to deal with a new issue in a timely and effective fashion. I would say our capability to identify issues early-on is excellent."

In contrast, many other respondents do not believe their firms are doing the best possible job of dealing with public policy issues of immediate concern, or of identifying early-on the issues most likely to affect them in the near future.

The Corporate Tracking Effort

Respondents were almost equally divided between those companies that have a "formal" tracking system and those that rely on informal exchanges, meetings, and briefings. About half use a network of informal relationships and assign specific individuals or groups with the dual responsibility of identifying critical issues and communicating the likely impact of these issues to top management.

Almost half the companies polled rely solely on their internal staff to track issues of concern. Six percent use outside consultants in addition to their internal staff. The use of outside consultants relates primarily to issues that extend beyond national boundaries; the most-often mentioned were environmental issues, international trade, protectionism, and U.S. tax reform. One respondent comments, "In the wake of the Chernobyl and Schweizerhalle accidents we have be-

Table 2: Companies' Evaluation of their Ability to Identify Key Public Policy Issues

Rating	*Percent of Companies*
Excellent	17
Good	61
Average	21
Poor	1
Total	100%

N = 140

come painfully aware that environmental disasters cannot be limited to a nation's borders. Not only must we refine our plant processes, but we must put more effort into emergency planning."

A formal tracking effort involving designated staff and resources does not always evolve into a formal issues agenda. Indeed, only 44 percent of the public affairs officers polled prepare such an agenda for their top management's review. Two-thirds of the respondents developing a formal agenda depend upon divisional vice-presidents or business-unit managers for input. Several respondents in this group say that they also meet regularly with "important politicians and leading state officials for discussion of politically sensitive issues."

Occasionally the process is reversed, and top management circulates its analysis of the issues to divisional vice presidents and business unit managers.

An executive of a British multinational noted:

> "Once a year both an operative plan and a strategic (medium-term) plan are prepared for every business unit. These plans represent the senior executives' perception of leading issues. Weekly summary reports are sent by telex to senior managers across Europe on issues of both general and specific interest. In addition, informal personal contact with key managers refines the list of issues for active public affairs staff involvement. For our company, it is a constant process of balancing resources with need."

A Swedish manufacturing executive reported, "We do not wait for the quarterly meetings. Reports are circulated to senior management in all departments as soon as issues arise."

Some firms report that they rely on meetings and briefings rather than the issuance of reports. "Our public affairs managers regularly participate in Board [of Directors] meetings. In this way, our directors hear first-hand what are the major public policy issues facing senior management," noted a French banker.

One company's "informal" agenda, could be considered quite formal in another, more relaxed business environment. Although a West German automotive executive regards his firm's process as generally ad hoc, he goes on to explain, "a very detailed briefing book is prepared for the annual general meeting. Less detailed but similar briefs are prepared describing quarterly results. In between, major technological and political issues are reviewed at a variety of senior management meetings."

Repondents were asked, if a formal issues agenda is not prepared for review, is there another manner in which senior executives are polled about their perceptions of leading issues? "Not in Europe," one manager responded. "We only do this in America," another said, citing as an example the current U.S. hazardous substance and toxic waste disposal issues.

Briefing Top Management

Companies that have formal issues-tracking procedures tend to have stronger involvement from their CEOs. Close to one-half the public affairs officers polled describe the contribution of their president or chairman as "significant," while an additional 39 percent describe the participation of this level executive as "very significant." This contrasts sharply with U.S. corporate practice where only one-third of the companies say their CEO participates in a significant manner in the issues-identification process.

Respondents from the banking sector described particularly precise procedures, perhaps reflecting their firms' concern with changes in the regulatory process. One bank manager wrote, "We have a public affairs committee, which is a subcommittee of the main board of the bank. It is chaired by our chairman, meets as required—which is now frequently—to review and counsel on public policy issues." Procedures of some companies include the following, according to an Austrian banker:

> "The bank has established two advisory bodies to the management board—a regional managers conference and a senior managers conference. Both of these advisory bodies regularly have public affairs issues on the agenda. The opinions of the managers are then reported to the management board."

Commented an executive of an Italian electronics firm:

> "My firm depends on the personal involvement of the president, vice-presidents and other senior executives. Issues-identification is imbedded in our planning process through dedicated management meetings and retreats."

Geopolitical Concerns

Large European companies must deal with a wide geographic range of public policy issues. Respondents were asked to rank geographic regions in terms of the time and attention paid to the various regions by the respondent and his or her department.

As Table 3 indicates, a weighted ranking places national issues at the top of the list for most respondents. Not surprisingly, these concerns centered around questions of taxation, financial regulation, and environmental controls. Pan-European issues were of concern to almost all the companies polled as they begin to alter their organizational structures to prepare for the integration of European markets in 1992. As discussed earlier, some companies expressed strong nationalist sentiments and a degree of apprehension about—if not opposition to—the removal of market barriers.

Global economic and trade questions are grouped by respondents under the umbrella of the international issues. As protectionist fears reach out from Europe across the Atlantic and North America to Japan, these become of critical significance to many firms.

Table 3: Ranking of Issues by Importance of Geopolitical Boundaries

Geopolitical Category	Ranking
National Issues (home country)	1
European Issues (general)	2
EC Member States	3
North America	4
International Issues (general)	5
Local Issues	6
Non-EC Member States	7
Middle East	8
Far East	9
Latin America	10
Africa	11
Oceania	12

Levels of Corporate Involvement

For the purpose of this study, three levels of corporate involvement in public policy issues were identified: active involvement, close monitoring, and general interest. (See Table 4 on page 32.) Each level reflects a different allocation of company staff and resources, thus indicating the level of concern with a particular issue.

On issues of primary concern to the company, where the level of interest is reflected by an active lobbying effort requiring the assignment of company staff and resources, companies are described as being actively involved. These issues tend to be those thought likely to involve legislation that could impede a company's manufacturing or marketing operations.

Close monitoring involves keeping a watchful eye on the development of an issue. In these cases, companies have not yet committed themselves to a lobbying effort or attempted to affect public debate by advertisements, public pronouncements, or the support of advocacy or special interest groups. However, they watch the issue closely through the use of company staff and, perhaps, outside resources, and track and report on developments.

Third, companies may merely have an "intellectual interest" in an issue because of its general impact on their nation's and/or Europe's economic and social systems. These firms will expend no special effort to collect information on such an issue, but will work to keep themselves informed about its development. Finally, as might be expected, there are some issues that firms say they pay no attention to at all.

For the purposes of this report, a list of issues that companies could choose from was provided in the survey. As mentioned earlier, the initial list of issues came from a polling of The Conference Board's European Public Affairs Council members. Additions were made based on routine monitoring of EC initiatives and reviews of secondary sources such as industry surveys, media coverage, public opinion polls, and public policy journals. In total, 24 major issue categories were identified. (See page 6.) Respondents were also asked to supply other issues that did not appear in the menu offered. The 43 separate issues listed in Table 4 reflect their response.

Table 4: Levels of Corporate Involvement in Public Policy Issues

TITLE OF ISSUE	Percent of Firms Actively Involved	Percent of Firms Closely Monitoring	Percent of Firms Reporting General Interest
1. Financial disclosure	51%	34%	13%
2. Protectionist measures	45	36	17
3. Financial Deregulation	44	30	24
4. Completing Internal Market	42	36	20
5. Research support	37	28	30
6. Environmental protection	34	26	31
7. Toxic wastes	32	17	34
8. Clean air	30	17	35
9. Clean water	29	20	34
10. European monetary system	29	43	20
11. Environmental constraints	27	25	35
12. Product liability	27	35	31
13. Financing mergers	26	30	32
14. Copyrights and patents	25	29	33
15. Cooperative R&D	24	23	39
16. Science education	22	27	41
17. Multinationalism	21	36	33
18. Tax credits	21	41	34
19. Education and business	21	29	42
20. Privatization	19	25	34
21. Telecommunications	18	30	40
22. Employment security	15	42	37
23. Job creation and retraining	15	32	48
24. Acid rain	13	18	44
25. Agricultural subsidies	13	13	25
26. Creation of monopolies	13	31	42
27. Plant closure statutes	13	28	44
28. South Africa	13	17	40
29. U.S. tax reform	13	31	37
30. Data flow restriction	11	32	44
31. Right-to-know	11	24	42
32. Community issues	10	14	40
33. Health issues			
a. AIDS	8	13	47
b. Substance abuse	7	18	50
34. Company health care costs	7	24	50
35. Comparable worth	7	22	51
36. Facilities for handicapped	7	19	53
37. Privacy	6	17	57
38. Racial discrimination	6	12	43
39. Elder care	5	14	49
40. Part-time work	4	17	53
41. Day care assistance	2	11	46
42. Maternity leave	2	13	55
43. U.S. budget deficit	2	26	51

Chapter 7
Moving Ahead

The tidal wave of change that is expected to sweep over Europe is causing public affairs executives to look closely at their methods for influencing change. Survey respondents were asked to indicate the methods they find most effective in persuading governments, stockholders, external constituents, the media, and the general public to support their views on particular public policy issues.

(1) *Single-issue lobbying.* Involves the highest level of corporate management and, often, outside consultants. Most often members of senior management meet with government officials, testify before legislative bodies, and meet with various interest groups in order to present their company's position. Forty-four percent of the respondents found this to be their most effective tool.

(2) *Working through trade associations.* When companies are concerned with a range of issues, or feel they are not large or strong enough to affect the outcome of an issue, they will work through an industry-specific trade association. The weight of the number of companies represented by the association often carrries a stronger message than a single lobbyist. Thirty-eight percent of the respondents describe this method as their first choice.

(3) *Working with groups of companies.* Often companies will work with groups of like-minded organizations rather than with trade associations. The reasons for choosing this method vary. For example, certain manufacturing companies may be concerned with a narrow regulatory problem regarding a particular product line. Sometimes there is not an effective trade association. Thirty-two percent of the respondents have found this to be the method of choice for them.

(4) Other means. Thirteen percent of the respondents chose a variety of other means, including paid advertisements, the support of pressure groups, outside public relations consultants, and, rarely, dependence upon elected officials.

Some of those concerned with the future of an integrated Europe do not believe that industry is showing its strength. An EC spokesman believes industry should take a much stronger role in lobbying for economic integration in 1992:

> "The Commission actually is a bit perplexed that industry is so quiet on the Internal Market. We could well do with some industry support in a lot of areas. For example, regarding transport, national ministers tend to hear only from their own national transport lobbyists, the people who provide transport. To take one example, if business air fares were reduced—or haulage rates or sea transport—it would be of benefit for any industry that is producing goods. That's the kind of area where there hasn't been enough industry lobbying.
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> "Insurance is another example. When you talk about insurance you tend to hear from the insurance business but not from people whose insurance bills would drop if there were more competition in the markets. So industry as a consumer of goods and services from other parts of industry is a very important area.
>
> "Steel is another example. Why should industry pay such high prices for steel? Because the steel industry is protected. Is that a good thing? As a general economic policy, or industrial policy, is it a good thing to have high-priced steel when you could have cheaper steel? Where is industry's voice in this?
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> "The successful integration of the market is not something that operates entirely independent of public opinion because it is linked to the people who have expectations. If ministers feel they are under pressure and feel that industry itself wants 1992, then it will push people a little further. If they feel like they are operating in the backwater, and no one cares what they do, they will feel less pressure.
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> "Industry shouldn't underestimate its own lobbying power. I don't necessarily mean direct lobbying, but through national business organizations and trade associations industry can make a case to the Commission and to government for pushing some of the directives through. Otherwise ministers will only hear from the people directly affected.
>
> "The Commission has yet to feel that industry actually wants 1992 to happen. If industry were to plan on the basis that it *will* happen, it is more likely to happen."